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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

COMMENTS OF EXECUTIVES OF CORPORATIONS IN RESPONSE TO THE QUESTIONNAIRE

OF THE

U.S. Congress.
Senate. COMMITTEE ON FINANCE.

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CHAPTER 2

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CONTENTS

	Page
Adams, K. S., chairman, Phillips Petroleum Co	163
Beise, S. C., president, Bank of America National Trust & Saving Association	167
Colbert, L. L., president, Chrysler Corp	183
Cordiner, Ralph J., president, General Electric Co	187
Curtice, Harlow, president, General Motors Corp	199
Ecker, Frederick W., president, Metropolitan Life Insurance Co	207
Fitzgerald, Edmund, president, Northwestern Mutual Life Insurance Co	221
Gund, George, president, Cleveland Trust Co	227
Holman, Eugene, chairman, Standard Oil Company of New Jersey	231
Jarvis, Porter M., president, Swift & Co	237
Jenks, D. B., president, Chicago, Rock Island & Pacific Railroad	243
Jerome, F. E., president, Seattle First National Bank	249
Kaiser, Henry J., president, Kaiser Aluminum & Chemical Corp	257
Keener, J. W., president, B. F. Goodrich Co	259

Vol. 2

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

PHILLIPS PETROLEUM CO.,
Bartlesville, Okla., March 28, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance, United State Senate,
Senate Office Building, Washington, D. C.

DEAR SENATOR BYRD: The attached are my replies to your letter of February 17. I have answered the questions where I could and have followed the suggestion in your letter in some cases of using the questions as a guide. I have also tried to answer part or all of the questions, which from my viewpoint seemed desirable or appropriate as you had suggested. Some of the questions are too technical from a financial standpoint for an industrial corporation to answer. In these cases I have so indicated this position.

Sincerely yours,

K. S. ADAMS.

QUESTIONNAIRE

1. Give a definition in your own words of deflation and inflation.

Inflation is the increase in general price levels from unsustainably rapid economic growth, with unemployment at a minimum, wages rising more rapidly than productivity, and supplies and inventories short. Deflation is the other side of the coin.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

This question is almost too broad to be answered.

My reaction in brief is that the national economic goal should be to promote sound growth with general stability of prices. Both inflation and deflation interfere with economic growth, therefore, both should be controlled if possible. This is purely a technical matter, but it seems it can be done by use of the Federal Reserve powers over money and credit supplemented by Treasury Department tax changes—both powerful weapons against inflation and deflation. The great trouble is reluctance to use these weapons versus inflation particularly on the wage-price problem.

The solution of the wage-price problem is difficult to find. It is either legislation or public education. I think it is one point where your committee should devote a major share of its attention.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942 to 1957. (You may wish to divide the period into two parts, 1942–1950 prior to the accord, and 1951–57.)

This question does not seem to be an appropriate one for an industrialist to answer. However, it is evident there has been less inflation

since 1953 when the Federal Reserve was once again able to use its powers over money and credit. The Federal Reserve policies seem to have been about as good as can be expected, at least since the accord between the Federal Reserve Board and the Treasury Department. The Federal Reserve Board should be allowed to have the same degree of independence it now has.

4. Beginning in August 1956 there was an increase in Consumer Price Index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar?

The answer is not a simple one. There were many contributing factors including wage and labor and Federal budget policies. Tight money did not prevent the rise in prices because the circulation of money increased. Prices probably would have risen more rapidly in the absence of tight money.

5. What effect does the management of the current public debt have upon the national credit structure and the economy of the United States?

I do not feel qualified to comment on the technical problems of debt management.

6. (*a*) Discuss in their relationship to one another and according to their judgment of their relative importance the following three objectives of economic policy in the United States:

1. Price stability;
2. Stability of production, demand, and employment;
3. Economic growth in production, demand, and employment.

(*b*) With respect to these three objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II—during the most recent two or three years—and especially during 1957.

This is another question that is almost too broad to answer. It would appear that our Nation would want to achieve all 3 of these objectives, which I consider as really 2 since the second and third overlap. We need growth for national and security and high living standards. We need price stability as much as possible. Real growth is not possible under inflation.

It seems in the 1956–57 period we achieved a rate of expansion which was not sustainable indefinitely. Investment boom contributed to a tight labor market and facilitated large wage increases. Developments in recent months have illustrated the consequences of these excesses and it appears that the Nation would have done better had the recent boom been less vigorous. We must place the objective of avoiding inflation close to the top of our list of economic objectives.

7. Give your opinion of the effect on our economy of current Federal, State, and local government spending.

8. Give your opinion of the effect on our economy of current Federal, State, and local taxation.

We can afford to pay the present level of Government expenditures if it is agreed that such expenditures are necessary. Our present taxes are barely sufficient to cover Government spending, yet Government spending would probably rise so long as international tensions persist. This points to a burdensome tax structure which needs to be eased through intensified economies in the Government and a complete overhauling of the tax system. Our tax system bears down un-

fairly on incentives to save and invest, to work hard, and to exercise initiative and enterprise. Our tax system needs to be simplified.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes, and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies, stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

I do not believe I am qualified to comment on such a specialized subject.

10. (*a*) Comment generally on the adequacy or inadequacy of the United States monetary system. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits.) Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

(*b*) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

This question seems too sweeping and technical for any but financial companies to answer. To attempt even general comments would involve more research work than is available to the average industrial company.

11. (*a*) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy.

(*b*) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full employment goals?

It is doubtful that inflation and rising unemployment can exist side by side for long. Particular prices may increase during a recession—for instance, beef prices may increase because of a reduction in supply. Moreover, the consumer price index tends to lag behind business conditions.

Prices may not decline in future recessions as much as in the past, because wage rates are likely to be maintained. A great many rigid factors have been built into our economy which place continued upward pressure on costs and prices despite greater unemployment, idle industrial capacity, and ample supplies of raw materials. If prices are to fall less in recession periods, efforts must be redoubled to keep them from rising in boom periods.

Gradual inflation would not be a desirable objective for our economy.

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy.

A growing economy always incurs debt. So long as private debt does not rise more rapidly than the ability to service it, debt makes a constructive contribution to the general economic advance.

13. Considering the financial condition of the United States, at what point, if any (in terms of unemployment, production, and consumer demand) should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy.

As the answers to previous questions indicated we should avoid both inflation and deflation. We should seek to facilitate the adjustments underway in business investment in new plant and equipment,

and in inventories, exports and consumer durable goods. These adjustments take time.

I do not feel qualified to determine at what levels of production, unemployment, or consumer buying, the Government should resort to fiscal policy in order to stimulate the economy. If the choice is between a tax reduction and a public-works program, my preference would be the former.

The first step by the Government should be to ease credit aggressively. The next step should be to cut taxes. Restoration of programs for accelerated depreciation would be especially desirable to stimulate industrial investment.

14. How much of a factor in your opinion has deficit spending by the Federal Government since the end of World War II been in contributing to or producing inflation?

I think it is difficult to measure the inflationary impact of postwar Treasury deficits. The initial inflationary surge after the war probably reflected less the Treasury's operations in those years than it did the results of the huge deficit spending during World War II. Nevertheless, the Government cannot be wholly cleared of responsibility for the inflation of the postwar era. A large Treasury budget and high-tax rates are in themselves inflationary; they reduce the volume of savings and force increased bank credit which in turn increases the supply of money.

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

In the answers to previous questions, it was pointed out that widespread acceptance of the doctrine of chronic inflation would be an unstabilizing factor and would prevent attaining economic growth and rising employment. I believe prospects for maintaining high employment are materially improved if inflationary pressures are curbed.

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

Escalator provisions which provide for wage increases in excess of the economy's productivity would add to inflationary pressures. Monetary and fiscal policies are more important in this respect than escalator clauses geared to productivity.

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.

The direct causes of the current recession include a shift from accumulating to liquidating inventories, a decline in the business investment boom, and a lag in consumer spending, especially for automobiles. Underlying these is the sustained rise in prices.

Perhaps the most important long-term objective would be to reform the income-tax structure. This would fight the recession, support our long-term growth and encourage businessmen to produce and sell goods at a rate that would raise our standard of living.

More favorable tax treatment of depreciation is another step the Government can take to encourage the continuing necessity of modernizing our business plants.

BANK OF AMERICA NATIONAL
TRUST & SAVINGS ASSOCIATION,
San Francisco, Calif., April 1, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate,
Washington, D. C.

DEAR SENATOR BYRD: In response to your letter of February 17, I am enclosing comments on your very thought provoking questions concerning United States economic policies. I trust that this response will be helpful to the Senate Finance Committee in its important inquiry on the financial condition of the United States.

If I can be of further help to the committee, please do not hesitate to call on me.

Sincerely yours,

S. C. BEISE.

COMMENTS ON QUESTIONS POSED BY SENATOR BYRD

1. Give a definition in your own words of deflation and inflation.

Deflation is a condition of general economic imbalance in which the total money demand for goods and services is less than the value of the available goods and services when these are valued at previously prevailing prices. Deflation may also be defined as a condition in which expectations of declining income, employment and prices cause investors and consumers to spend less than would otherwise be the case, thus reducing the level of demand upon which high levels of income and employment and the previously existing cost-price structure rest. Deflation is usually accompanied in varying degrees by declines in the prices of equities, stable commodities and some manufactured goods, reduced demand for bank loans, rising unemployment and a growth of idle plant capacity.

Inflation is a condition of general economic imbalance in which the total money demand for goods and services is greater than the value of goods and services available when these goods and services are valued at previously prevailing prices. Inflation may also be defined as a condition in which expectations for rising levels of money income, employment and prices cause investors and consumers to spend more than would otherwise be the case, thus increasing the pressure on available resources and giving rise to higher prices and costs. However, inflationary conditions may exist with little or no increase in the level of prices if rationing and direct administrative controls over prices are in use. Although inflation is often associated with full employment of labor and plant capacity, it may exist in the presence of substantial unemployment of labor and idle plant capacity, largely because of rigidities in the structure of costs and prices which prevent or retard downward adjustments required to increase employment and plant utilization.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

In a democratic society, properly implemented monetary and fiscal policies afford the greatest promise for the avoidance of inflation and deflation. The basic structure of monetary and fiscal policies should be so constructed and directed that total money demand is held within a range consistent with full resource utilization and the most favorable growth of productive capacity without increases or decreases in the general level of prices.

There is a need for a searching review of monetary and fiscal policies to determine:

(1) whether the basic framework of policy formulation—i. e., the objectives of policy, the distribution and coordination of policymaking authority, and the means of policy implementation—is conducive to full utilization and the most favorable growth of productive capacity; and

(2) whether responsibility for policy formulation and implementation is clearly enough defined and sufficiently broad to facilitate effective control of money demand through monetary and fiscal policies.

Some specific areas in which exploration and reevaluation of present laws may be needed are:

(1) the structure and level of rates of taxation of personal and corporate incomes in relation to general economic well-being and economic growth;

(2) the differential treatment of various types of business institutions with respect to allowable reserves and allocation of surplus in the calculation of net taxable income, with proper regard for socially desirable ends;

(3) the Federal budgetary process, including departmental cash disbursement policies and their relationship to monetary policy and economic stability;

(4) the control of Federal credit agencies and the coordination of their activities with the policies of the monetary authorities;

(5) the need for uniform regulation, consistent with socially desirable ends, of various types of business institutions competing in the same markets;

(6) control by the Federal Reserve of the credit expansion potential of nonbank financial institutions.

There is particular need for simplification and downward revision of the present structure of legal reserve requirements of members of the Federal Reserve System. We favor the approach suggested by the Economic Policy Commission of the American Bankers Association.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942 to 1957.

The large expansion of the money supply and of the economy's liquidity in general, which took place between the years 1942 and 1946, gave rise to serious problems of monetary control in the postwar decade. Much of the cost of the war was financed by Government borrowing, with the result that the general public emerged from the

period of wartime shortage of goods with large holdings of liquid assets. This huge overhang of liquidity at the end of the war undoubtedly did much to ease the transition to a peacetime economy without the recession which was widely held to be impending at the time. Nevertheless, the ease and rapidity of the adjustment, the continued existence of large liquid holdings for some time after the end of the war, and, above all, the official support of the Government securities market after the war, posed major problems for monetary policy.

Federal Reserve restraint of inflationary pressures between 1946 and 1951 would certainly have been more effective if the policy of supporting Government securities at artifically high prices had not been in effect. The experience of this period demonstrated quite clearly that the stabilization of security prices is incompatible with the basic meaning of monetary policy and is inconsistent with the primary role of fostering real economic growth and stability and the full utilization of resources.

Although Federal Reserve policy-implementation since 1951 has not proved completely successful in restraining inflationary upsurges, it has shown that a flexible monetary policy, even against considerable odds, is a potent stabilization device. The large money supply and high liquidity resulting from the period of war finance continued to complicate the problem of monetary control in the 1951–57 period. By increasing the velocity of circulation of money, the economy was able to offset, at least in part, the restraining effects of monetary policy exercised through the control of the quantity of money. In this process, nonbank financial institutions played an important role. By issuing what were regarded by the public as highly liquid obligations as substitutes for money balances, these financial entities made it possible for the public to economize its holdings of money balances without suffering a serious reduction in liquidity. This permitted the financial system as a whole to increase its loans and investments at the same time that monetary policy was restricting the capacity of the commercial banks to increase their loans and investments. A more successful monetary policy in the period 1951–57 would probably have required some form of control over the operations of nonbank financial institutions.

4. Beginning in August 1956 there was an increase in the Consumer Price Index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar?

After July 1956 the total money demand for goods and services exceeded the value of goods and services available, when valued at previously prevailing prices. With productive capacity and employment already rather fully utilized, increases in money outlays for consumption and, particularly, for investment goods could not call forth appreciably larger supplies. There resulted a competitive bidding that raised prices directly as well as indirectly through (a) moving inventories more rapidly, (b) increasing order backlogs, and (c) otherwise indicating to sellers the presence of a strong market. The price rises extended to other resources, including labor, raising costs of production. Increased prices could be, and were, financed by a more active use of the money supply, and were not dependent upon increases in the money stock.

The expansion responsible for the 1956–1957 rise in the Consumer Price Index was sparked by factors which included the following:

(1) tax revisions conducive to increased consumption and particularly to investment outlays;

(2) liberalization of mortgage terms guaranteed by government agencies;

(3) inadequate surpluses in connection with a rising level of government expenditures;

(4) a significant increase of the economy's liquidity as a result of an easy monetary policy that was aimed successfully at reversing the economic downturn of early 1953.

Once underway, the expansion proceeded to an inflationary stage largely because the financial system was able to expand its loans and investments despite increasingly restrictive Federal Reserve control over bank credit, and thereby to increase the volume of spending with borrowed funds. To a considerable extent the monetary authorities appear to have been hampered in their efforts to restrain this expansion partly because a large part of the financial system is not directly subject nor quickly responsive to Federal Reserve policies, and partly because coordination of fiscal and monetary policies was not carried as far as circumstances required.

5. What effect does the management of the current public debt have upon the national credit structure and the economy of the United States?

Debt-management policy has effects upon the national credit structure and the economy of the United States in several respects.

(1) The distribution of maturities of U. S. Government securities outstanding is an important element determining the liquidity of the national credit structure. A shift from long-term financing to short-term financing tends to increase the liquidity of the national credit structure, while a shift from short-term to long-term financing tends to decrease its liquidity. Other things equal, an increase in liquidity is inflationary or antideflationary, while a decrease in liquidity is deflationary or anti-inflationary. In recent years, shifts in the composition of maturities may have had some tendency to be destabilizing, because the average maturity of the Federal debt has been lengthened in recessionary periods and shortened in expansionary periods. Growth in the money supply and in the volume of savings, of course, increases the ability of the economy to hold debt, thereby ameliorating these particular destabilizing influences, while adding inflationary and deflationary influences of their own.

(2) New financing and refinancing accomplished through sales of Government securities to the commercial banking system increases, of course, the total quantity of money in circulation. This tends to be inflationary or antideflationary unless the public's demand for money balances, at prevailing levels of prices of goods and securities, is rising correspondingly, as may well be the case in periods of recession.

Over the past decade this aspect of debt management policy has probably worked in a stabilizing direction because a greater amount of refinancing and new financing has been conducted through the commercial banking system in times of recession than in times of economic expansion. This has tended to offset the destabilizing effect of changes in the average maturities of Government securities.

(3) The magnitude and timing of refundings and new cash issues affect the prices and yields of private as well as public issues. Large Treasury operations and poor timing can disrupt financial markets, for example, by glutting them with new Federal issues at times when they are saturated with private issues. On the other hand, good timing and operations of the proper magnitude can help to stabilize financial markets. Since the time is seldom, if ever, ideal for extending the debt structure, long-term options should be offered frequently, with due regard for market conditions and the general public interest, so that gradual lengthening, or at least offsets to debt shortening, continually take place.

(4) Coupon rates on Government securities are generally set in accordance with prevailing market rates and, to some extent, are regarded by the market as indicators of the trend of interest rates. The effect of this process is to accelerate or dampen already existing movements in the general level of interest rates, depending upon how much the Treasury shades its coupon rates in one direction or the other.

Debt-management operations influence the liquidity of the national credit structure, the quantity of money in circulation, the flow of funds among the various financial markets, and the trend of interest rates. Each of these factors, in turn, influences the level of spending, especially the level of spending with borrowed funds. By thus affecting total money demand, debt-management operations affect the general level of prices and the rate of utilization and growth of productive capacity.

6. (*a*) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

1. Price stability.
2. Stability of production, demand, and employment.
3. Economic growth in production, demand, and employment.

Only the first and third of these objectives (i. e., price stability—in the sense of a more or less constant general price level, rather than a smoothly rising one—and economic growth in production, demand, and employment) should be long-term objectives of national economic policy. Complete stability of output—in the sense of a constant, absolute level of production, demand, and employment—is not a relevant economic objective in an economy with an increasing population and a rapidly advancing technology. Nor would it be an admissible objective even in an economy with a constant population, for improvement of the material welfare of a constant population requires growth of productive capacity.

Even if stable production were taken to mean a smoothly rising output at an unchanging rate, this would not constitute a feasible goal of economic policy in a free economy. As economic growth tends to come in waves, uninterrupted progress in the raising of material welfare cannot be expected. However, inflation and deflation tend to accentuate the unavoidable fluctuations in the pace of economic growth, and the resulting distortions in the structure of production probably lower the rate of advance below what it would be in the absence of inflationary and deflationary periods. Avoidance of inflation and deflation is, therefore, not only consistent with but actually essential to orderly economic growth. The avoidance of inflation and deflation

implies reasonable stability in the growth level of prices. Consequently, price stability and economic growth are essential and concomitant objectives of national economic policy.

(*b*) With respect to these three objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II—during the most recent 2 or 3 years—and especially 1957.

The general upward drift of the level of prices since the end of World War II is a clear indication that the economy tried to expand at a greater rate than was possible with the available supplies of productive resources. If inflationary pressures had been held in check more effectively during this period, as might have been possible if fiscal policies had been better coordinated with monetary policy, and if the monetary authorities had been in a position to affect directly a larger part fo the financial system, the result might very well have been a more stable growth rate over this period and in the years ahead. The material welfare of the economy might have been raised more by a stable growth rate over these years than by alternating periods of high and low growth rates. Especially, if monetary and fiscal policies had been more effectively used in 1955 and 1956, the inflationary excesses of those years might have been mitigated and the reversal in 1957 made less abrupt.

Considering the underlying strength of demand in the postwar decade, more effective and better coordinated monetary and fiscal policies could have probably contributed more to price stability without impeding full utilization and orderly growth of productive capacity.

7. Give your opinion of the effect on our economy of current Federal, State, and local spending.

Federal, State, and local government spending has effects upon (1) the level of total purchasing power in the economy, (2) the composition of output in the economy, and (3) the rate of advance of material welfare of the economy.

(1) Federal, State, and local spending raises the level of total purchasing power in the economy because some part of this spending is financed by taxing away and borrowing funds that would not otherwise be spent so soon. Fluctuations in government spending, like fluctuations in any major type of spending, tend to produce fluctuations in the level of total spending in the economy, thereby affecting the general level of prices and the rate of utilization and expansion of productive capacity.

(2) Government spending alters the composition of output in the economy because certain governmental goods and services would either not be provided at all or not provided in the same quantity if the task were left completely in private hands. Whether government spending increases or decreases the efficiency of allocation of resources depends upon whether the goods and services provided by government increase the welfare of the population more than would the uses to which the resources would be put if these goods and services were not provided by government.

(3) Since government spending affects both the level of total spending and the allocation of resources in the economy, it has significance for the rate of growth of productive capacity and material welfare. It is obvious that greater progress could be made in expanding pro-

ductive capacity for consumption goods if a smaller share of the Nation's output could be devoted to military equipment, with adequate transition to maintain total demand. Theoretically, there is a level and composition of government spending that at any one time would be most conducive to orderly growth in productive capacity and material welfare, although the precise definition of this theoretical magnitude is a difficult, if not impossible, task.

8. Give your opinion of the effect on our economy of current Federal, State, and local taxation.

Federal, State, and local taxation, like Federal, State, and local government spending, affects (1) the level of total purchasing power in the economy, (2) the composition of output, and (3) the rate of advance of material welfare of the economy.

(1) Taxation tends to lower the level of total purchasing power in the private sector by reducing the purchasing power of taxpayers. It probably does not reduce demand by the full amount of taxes, however, because a part of the funds obtained through taxation come out of funds that might not otherwise have been spent so soon.

(2) The composition of output is altered, because the relative composition of private spending in the presence of taxation is not the same as it would be in the absence of taxation.

(3) Since taxation affects the level of total spending and the composition of output, it has significance for the rate of advance of productive capacity and material welfare. Theoretically, there is some structure and level of taxation that would be most conducive to maximum, effective growth of productive capacity and material welfare, but a precise definition of this theoretical magnitude, structure and level is a difficult, if not impossible, task.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes, and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

Fiscal policy relates to the raising and disbursement of Government revenues. Debt policy encompasses decisions concerning the flotation, interest rates and maturity of public debt instruments. Because Government revenues may be raised by borrowing as well as by taxation, fiscal policy, in a broader sense, may be said to encompass debt policy as well. Monetary and credit policy concerns regulation of the cost, availability and supply of credit and money generally. Fiscal, monetary, and debt-management policies all are broadly concerned with the financial aspects of national economic policy. The general economic effects of decisions in these policy areas are discussed below.

FISCAL POLICY

1. Expenditures

An increase in the level of Government expenditures tends to increase total purchasing power in the economy. If this increase is accompanied by an increase in the Government deficit or a decrease in the Government surplus on current account, an additional stimulating effect will be exerted upon total purchasing power. Any increase in total purchasing power tends, of course, to increase output on prices, or both. A decrease in Government expenditures, on the other hand,

tends to decrease total purchasing power in the economy, and consequently output or prices, or both. If a decrease in Government expenditures is accompanied by a decrease in the government deficit or by an increase in Government cash surplus, an additional depressive effect will be exerted upon total purchasing power. A decrease in total purchasing power tends, of course, to decrease output or prices, or both. By varying the level of Government expenditures and the size of deficits and surpluses in such a way as to offset changes in private spending, fiscal policy can exert a stabilizing effect upon the general level of prices and upon the rate of utilization and growth of productive capacity.

2. Taxation

An increase in taxes tends to decrease total purchasing power in the economy; this increase may, of course, be accompanied by a rise in Government spending, and this may be of sufficient magnitude to offset the depressive effect which increased taxation has on private spending. A decrease in taxes tends to increase total purchasing power; this decrease may be accompanied by a decline in Government spending, and this could well be of sufficient magnitude to offset the stimulating effect that decreased taxation has upon private spending. An increase in taxes, in conjunction with an appropriate decline in the Government deficit or an increase in the Government cash surplus could be used to restrain or reduce private spending in such a way as to contribute to stability in the general level of prices and the rate of utilization and expansion of productive capacity. Conversely, a decrease in taxes, in conjunction with an appropriate increase in the Government deficit or a decrease in Government cash surplus could be used to stimulate private spending in such a way as to contribute to stability in the general level of prices and the rate of utilization and expansion of productive capacity.

3. Debt management

The debt-management phase of fiscal policy involves three types of operations: Sale of new issues for cash, redemption of maturing issues with cash, and refunding of maturing issues with new issues.

(*a*) *Sale of new issues for cash.*—Three types of purchasers of Government securities can be distinguished: The Federal Reserve banks, the commercial banks, and the public. Purchase of new Treasury issues (indirectly) by the Federal Reserve banks is the most inflationary way of financing a Government deficit, for as the Treasury spends the newly created funds thus acquired, the excess reserves of commercial banks are increased, and of course the money supply as well. Purchases of new Treasury issues by the commercial banks tends also to be inflationary but less so than purchases by the Federal Reserve banks. While purchases by the commercial banks, like those made by the Federal Reserve banks, tend to increase the quantity of money in circulation, commercial bank purchases reduce the excess reserves of commercial banks by a fraction of the transaction, thus restricting their ability to contribute to further monetary expansion. Purchases of new Treasury issues by the public are the least inflationary means of financing a Government deficit.

(*b*) *Redemption of maturing issues with cash.*—Redemption of Treasury issues held by the Federal Reserve banks is the most deflationary way of retiring debt—if these redemptions are made from

Treasury balances in Federal Reserve banks, they are kept out of immediate circulation, and if the payments are made from Treasury balances in commercial banks, they reduce the reserves of these institutions. Redemption of Treasury issues held by commercial banks has the immediate effect of reducing the total volume of demand deposits if the payments are made from Treasury balances with commercial banks, so that in the first instance it appears to be deflationary. However, this reduction in the total volume of demand deposits increases excess reserves, and the banks can, therefore, increase their demand deposits back to the former level by purchasing private debt. By thus facilitating an increase in private spending, the redemption of debt held by commercial banks may, although it need not necessarily, tend to be inflationary. Redemption of such debt from Treasury balances in Federal Reserve banks increases excess reserves even more. Redemption of Treasury issues held by the public tends to be inflationary, because it increases the liquidity of the public and expands the public's capacity to spend.

(*c*) *Refunding of maturing issues with new issues.*—The issuance of long-term Treasury obligations in refundings reduces the liquidity of holders of debt and thus tends to be deflationary. The issue of short-term Treasury obligations in refundings does not decrease the liquidity of debt holders appreciably and thus does not do much to retard the decline in the average maturity of the debt associated with the passage of time. Short-term issues are thus less deflationary than long-term issues, and less inflationary than cash redemption. However, any refunding of Treasury debt, whether into long-term or short-term securities, tends to be inflationary or antideflationary if it is associated with a shift of ownership to the commercial banks and an increase in the quantity of money. Similarly, a refunding of either short- or long-term Treasury obligations associated with a shift of ownership from commercial banks, and a decrease in the quantity of money, tends to be deflationary or anti-inflationary.

Fiscal policy can be implemented in a variety of ways to exert a stabilizing effect upon economic activity. During a period of economic expansion, the most restrictive fiscal policy would include the following ingredients: (1) a decrease in the level of Government expenditures, (2) an increase in taxes, producing a cash surplus, (3) the impounding of this surplus in the Federal Reserve banks, or the use of it to retire Treasury debt held by the Federal Reserve banks, and (4) a shift in the composition of outstanding Treasury debt by refunding maturing issues into long-term issues without the creation of new money by the banking system. In a period of recession, the ingredients of the most expansionary policy would be (1) an increase in the level of Government expenditures, (2) a decrease in taxes, producing a cash deficit, (3) the financing of this deficit by sale of securities to the Federal Reserve banks or to the commercial banks if additional reserves are supplied by the Federal Reserve authorities, and (4) a shift in the composition of outstanding Treasury debt by retiring maturing issues in cash and financing the retirement preferably by reducing cash holdings or, secondarily, by short-term issues placed with the Federal Reserve.

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MONETARY AND CREDIT POLICY

Monetary and credit policy affects the level of purchasing power by influencing the quantity, cost, and availability of loanable funds. This occurs largely through the control of the reserve position of member banks. By reducing the discount rate and legal reserve requirements and by purchasing securities in the open market, the Federal Reserve authorities can strengthen the reserve position of member banks, thus increasing their capacity to lend. By raising the discount rate and legal reserve requirements and by selling securities in the open market, the Federal Reserve authorities can diminish the reserve position of member banks, thus reducing their capacity to lend.

A reduction in the capacity of member banks to lend tends to decrease the quantity of loanable funds available to borrowers. By increasing interest rates and by reducing the availability of funds, member banks allocate this reduced supply of funds among borrowers. To the extent that a reduced supply of funds from the members banks is associated with a reduced supply of funds from lenders in general, the volume of spending with borrowed funds is decreased. A reduction in the volume of spending with borrowed funds tends to reduce total purchasing power, and in a period of economic expansion this would tend to stabilize the general level of prices and the rate of utilization and growth of productive capacity.

The reserve positions of commercial banks can also be influenced by the Treasury's policy with regard to the nature and location of the balances it holds. A shifting of Treasury balances from cash or Federal Reserve deposits to commercial bank accounts increases the reserve position of commercial banks, while a shift in holdings from commercial to Federal Reserve banks or to cash reduces commercial bank reserve positions.

Fiscal policy, through Government expenditures and taxes, operates upon the level of purchasing power by increasing or decreasing Government and private spending directly. Monetary and credit policy works less directly by attempting to regulate the volume of spending with borrowed funds through changes in the quantity, availability, and cost of loanable funds. Although the action of the monetary authorities is more indirect, there is good reason to believe that it is just as powerful as fiscal policy. Monetary policy can be altered more quickly than can fiscal policy. Therefore, monetary policy is capable of achieving a greater part of its potential power as a stablization device. This conclusion seems reasonable notwithstanding the automatic stabilizing effects of certain aspects of fiscal policy. The principal automatic stabilizing effects are associated with the progressive nature of the personal income tax and with unemployment compensation. Although these aspects of fiscal policy have some stabilizing influence upon economic activity, this influence is somewhat secondary to the effects of other aspects of fiscal policy and to the effects of monetary and credit policy.

10. (*a*) Comment generally on the adequacy or inadequacy of the United States monetary system. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits). Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

The United States monetary system today is the result of over a century and a half of evolutionary legislation. There is little doubt that a wide range of reforms would be suggested by many individuals, groups, and organizations, if offered the opportunity of extensive legislative change at this time. A meaningful evaluation of the adequacy of the monetary system today can be made only if specific criteria are posed.

1. Has our monetary system provided an efficient payments mechanism?

Since the passage of the Federal Reserve Act of 1913 and the various reforms of the early 1930's, we have had a very efficient payments mechanism.

2. Has our monetary system provided adequate credit facilities?

An alleged deficiency of credit facilities has frequently been used as the rationale for the establishment of Government credit agencies and for the subsidization and promotion of the development of private lending institutions outside the banking system. To the extent that such deficiencies have existed, one of the most important reasons can be found in the restrictive influences under which the commercial banking system operates. Despite this, the banking system has done much to expand its operations to remedy alleged deficiencies in lending facilities. A great deal more could have been achieved if public policies had been directed more to strengthening and broadening the monetary and banking system than in affording means of circumventing it. It should be recognized that the establishment of many Government credit agencies and the promotion of certain types of nonbank financial institutions have proceeded from a desire to provide services commercial banks were not permitted to render.

3. Has our monetary system provided stability in the value of money?

It is obvious, of course, that our monetary system has not proven adequate to assure stability in the value of the dollar. The reason lies to some extent in a lack of coordination within the area of fiscal policy and between monetary and fiscal policy. It also lies in the nature of the financial structure and the problems it poses for the implementation of monetary policy. Even with the good effort of recent years, the monetary authorities have been unable to stabilize the value of the dollar, because they do not have adequate control over financial institutions outside the monetary system.

While nonbank financial institutions cannot create demand deposits as can banks, such institutions can "create credit" in the sense of transmitting loanable funds. This increased variety of financial services, together with the accompanying growth of nonbank financial institutions, has enabled a growth in income to be financed with progressively smaller additions to the money supply. As a result, traditional monetary controls, which are directly applicable only to banks, are being brought to bear on an increasingly narrow sector of the financial structure.

Nonbank financial institutions are beyond the direct influence of the monetary authorities because they are not subject to variable reserve requirements, nor are they directly affected by Federal Reserve open-market operations and rediscount policies, as are banks. Their operations are affected only indirectly through the application of

monetary controls to the commercial banks, which administer the payments mechanism. Consequently, in periods of inflation when monetary authorities are attempting to curtail competition for resources by restricting the money supply, nonbank financial institutions become vehicles by which the velocity of circulation is accelerated and by which competition for resources is intensified. As a result, attempts by the monetary authorities to compensate for such increases in deposit velocity by further restricting commercial bank lending tend to enhance the competitive position of nonbank financial institutions with respect to banks. Aside from the question of equity involved, this reduces the relative size of the base on which monetary authorities exercise their powers in their attempt to control the inflationary effects of the credit operations of the entire financial system.

Effective implementation of monetary policy in the interest of promoting sound economic growth and well-being would be facilitated if nonbank financial institutions were more responsive to policy implementation. Monetary policy cannot make its full contribution to this goal if it is applied to only a portion of the financial structure.

(*b*) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

Our fiscal system, particularly the tax structure, does not lend itself well to compensatory fiscal policies, and is in need of a thorough and careful review for the purpose of making it a more effective instrument of national economic policy. The fiscal system should facilitate to the greatest possible extent the fulfillment of the basic objective of economic policy which should be the promotion of orderly economic growth and the economic well-being of the public. To do this it must be flexible, not only in the sense of adjusting to change per se but adjusting in a manner which will be consistent with this basic policy goal. Flexibility requires general acceptance of the idea that the annual budget need not be in balance every year, and that the size and movement in the public debt is not significant in itself but only in relation to the state of the economy. With this flexibility must go measures to assure that there will be appropriate budgetary surpluses during inflationary periods. Otherwise the deficits in periods of recession which grow out of tax and expenditure policies will set the stage for persistent inflation and a rate of growth in the public debt which would not be consistent with the ultimate general policy objective of sustainable economic growth without inflation. Fiscal policy is too powerful a force in the economy to be ignored. It may be harnessed and used effectively in the public interest.

Apart from the need for flexibility, the fiscal system should be reviewed for consistency, equity, and economic effect of tax rates and the incidence of taxation. The budgetary process and particularly the process of cash disbursements by Government departments should be reviewed. The latter is especially important in connection with economic policy because disbursement schedules may conflict with the requirements of sound economic policy.

Some taxes lend themselves more readily to counter-cyclical use than other types. Relatively more reliance should be placed on the type of taxes most amenable to compensatory use. This entire area should be thoroughly studied to make the taxing mechanism a more effective instrument of economic policy.

11. (*a*) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy?

The paradox referred to in this question undoubtedly relates to the observation that unemployment and prices may sometimes be observed to rise together, instead of alternatively, as in the usual business cycle experience. A phenomenon of this nature is most likely to be present as the economy tapers off from a boom. This situation arises from the existence in our economy of rigid elements which do not adjust rapidly and easily to changing conditions.

A further factor to note is that, with increasingly widespread unemployment compensation benefits, income and demand do not fall commensurately with a decline in employment, thus lending support to market forces which are boosting prices even though employment may have turned downward.

It should also be noted that forces which do not stem from business conditions influence the level of output and prices independently of the level of employment. The influence of weather and other catastrophes on production of specific goods, for example those dependent on growing conditions or transportation, can result in price increases regardless of the state of unemployment.

(*b*) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full employment goals?

We need not accept a gradual inflationary trend as desirable or necessary to achieve and maintain "full employment"—by which we mean the employment at a high level of the employable labor force not in transition between definite job commitments. Theoretically, a stable price level is consistent with full employment in this sense and, in fact, there have been periods in our history during which reasonably full levels of employment were maintained with reasonably stable prices.

Inflation cannot be scheduled and programed at a certain rate. It is progressive and cumulative. To open the door only slightly to inflation as a matter of conscious policy is to risk having it flung open violently. To assume that a fundamental distortion in the price level is necessary to achieve full employment is to assume that every other alternative has been exhausted and that we are helpless to achieve this end without such a step. This is simply not true. Neither our monetary machinery nor our fiscal system is fully adequate to cope with this problem and both should be thoroughly overhauled as a first step in removing excessive fluctuations from the full-employment growth of our economy.

Attention also needs to be given to other aspects of this problem. Even if the general price level were to be held reasonably stable by monetary and fiscal policies the rate of utilization of productive capacity may be reduced below the full employment level by inflexibility in price and wage policies. Greater flexibility in this area of the economy would contribute to the maintenance of both price stability and full employment. A rising price level is the price we pay for rigidities in our economic structure; it is not the price that we need pay for full employment.

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy?

In our private-enterprise economy, growth of private debt is essential to economic progress, for it is the principal means by which saving is converted into investment in productive facilities and in other forms of real capital goods. A rate of growth of private debt which is faster than growth in the capacity of the economy to save and create productive facilities—unless public debt is correspondingly reduced—is not only a threat to the stability of the economy but may actually precipitate economic instability. The inflationary periods since the end of the war have been associated with an excessive rate of expansion of private debt. Once excessive debt has been created, it becomes a burden to the economy which increases in weight in the presence of an economic downturn.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy?

It is impossible to prescribe a specific point in terms of unemployment, production and consumer demand at which the Federal Government should undertake major countercyclical measures. Economic policy must be based on analysis of many nonstatistical as well as statistical indicators. With respect to statistical indicators, not only their level at any given time, but their direction and rate of change must be taken into consideration. Among the most important indicators whose level, direction, and rate of change reveal what is happening to the economy are indexes of unemployment, industrial production, wholesale prices, consumer prices, personal disposable income, inventory changes, investment in plant and equipment, and housing starts. These indicators, however, act in different ways and rarely all move in the same direction let alone at the same pace. Consequently their interpretation must depend on skillful analysis and sound judgment. There are no mechanical or universal formulas which can provide an automatic signal for the timing, nature, or magnitude of economic intervention by the Government.

14. How much of a factor in your opinion has deficit spending by the Federal Government since the end of World War II been in contributing to or producing inflation?

Deficit spending by the Federal Government since the end of World War II was not a significant contributor to inflationary pressures except as it was associated with wartime expenditures in 1952 and 1953.

Increases in total Government expenditures, rather than Government deficits have been the more important inflationary force in the economy.

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

Yes, full employment goals can be attained while maintaining a stable value for the dollar, if monetary and fiscal policies are properly implemented and if pricing of goods and services can be made more flexible.

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

Escalator provisions tend to reinforce and magnify, rather than dampen, inflationary and deflationary pressures on prices. When the

price level is rising, such provisions increase inflationary pressures by increasing wages and costs. When prices are falling, downward adjustments in wages tend to accentuate the price decline, primarily through the lowering of money income. Not only are the prevailing price movements accentuated in those escalated industries already in the vanguard of inflation or deflation, but escalation may also cause wage rates to rise in inflation or fall in deflation in industries whose prices were stable or were moving in the opposite direction from that of the general price level.

The effects of two-way wage escalation on employment are less clear. Basically, the problem consists of the relative influence on employment of the effects of variable consumer purchasing power on the one hand, and variable labor costs on the other. In inflation, with full employment, higher wage costs do not restrain demand for labor as they would if prices could not be increased to cover rising costs. During deflation, the demand for labor may not rise appreciably in response to a slight decline in wages if, as is likely to be the case, prices and profits are declining more rapidly. In fact, under these conditions employment might well decline, with a consequent reduction of income and demand in general.

A stabilizing device should operate to restrain excess demand for labor and goods in periods of inflation and to increase it in times of recession. On balance, escalator contracts do neither and therefore are not a stabilizing influence either for employment or for prices.

17. List briefly and discuss what you consider the causes of the present recession, and what should be done to terminate it.

The more immediate causes of the present recession are: (1) creation of excess capacity in the economic upswing of 1955–57; (2) cutbacks in Government defense orders in 1957; and (3) reduction of purchasing power of consumers through price increases in 1956 and 1957.

These developments coincided with a somewhat longer-term decline in housing construction and in agriculture. Earlier surging demand for houses, automobiles, and all kinds of appliances could not be indefinitely sustained at their peak levels. The subsequent decline in demand for these goods reflects in some measure a temporary satisfaction of pent-up demand at prevailing price and income levels, and a need to digest the debt created to finance peak sales.

Inventory liquidation has added to the economic decline since the fourth quarter of last year.

Finally, although the current recession does not appear to have been caused by economic developments abroad, it does not seem to have been ameliorated by them either, as was the case in the 1953–54 recession when the business buoyance and economic strength of other countries helped turn the tide here.

Appropriate action to terminate the present recession might include:

1. An expansion of those vitally necessary governmental expenditures which have been delayed somewhat or restricted during the previous period of rapid expansion. These include such projects as defense expenditures, road construction, needed public facilities, water development, etc.

2. Some excise taxes should be reduced or eliminated. Particular attention should be given to those categories of products where such action could be expected to lead to an expansion of demand.

3. Temporary liberalization of unemployment compensation with respect to the length of time for which unemployment payments can be made.

4. Further reduction in the reserve requirements of member banks to assure ample availability of loanable funds.

5. A reduction in personal income taxes when and if an adequate and thorough apraisal of the situation demonstrates that such action would be appropriate.

A sizable cut in personal income taxes would help to absorb the substantial excess capacity which is one of the drags on our economy at the present time. On the other hand, a premature cut in income taxes would serve to aggravate the actual and potential inflationary pressures which are still evident in some parts of the economy. Moreover, tax reductions, by their nature, are an inflexible instrument, and premature or excessive reductions cannot readily be reversed. Accordingly, a decision to cut taxes should not be made precipitately, but only when the need has been demonstrated.

Once need is evident, a cut should be made promptly and, if necessary, should be partially retroactive. The size of the reduction should be large enough to be really effective in stimulating consumer spending.

In order to make tax policy a more effective weapon in dealing with future recessions and inflations, it may be desirable to study the possibility of delegating to the President or Secretary of the Treasury (possibly with the concurrence of the appropriate committee of the Congress), the authority to reduce or raise personal and corporate income taxes when in his, or their judgment this seems desirable. Such delegation should include the provision that any tax rate change may not exceed some specified percentage nor be in effect beyond some specified period of time. In this way, the Congress would retain ultimate control over the taxing power but greater flexibility in the use of this power would be achieved. The adoption of this procedure would involve some rather basic changes in the environment in which tax policy presently operates. For this reason the question of tax reduction to combat the current situation should be considered independently of the longer-run question of whether the suggested procedure would be desirable.

CHRYSLER CORP.,
Detroit, Mich., May 5, 1958.

Hon. HARRY F. BYRD,
United States Senate,
Washington, D. C.

DEAR SENATOR BYRD: We have given considerable thought to the questionnaire dealing with broad aspects of American fiscal policy, and are attaching some comments which we hope will be useful to your committee.

We would like to emphasize one of our comments dealing with a specific tax issue. Perhaps the most effective single stimulus the Government could contribute toward a rapid and vigorous recovery from the present depressed conditions in the automobile industry would be the removal or drastic reduction of the discriminatory excise tax on automotive products. Prompt action on this subject by the Government with retroactive provisions to cover current purchases, holds out the greatest promise of stimulating retail automotive sales.

Presently many prospective customers are delaying purchase of new automobiles because of the uncertainty over the excise-tax issue. Favorable action on the excise tax could bring them into the market quickly. In addition, many other customers would be attracted by the tax savings and decide to buy a new car now.

We appreciate this opportunity to submit our thoughts to you.

Sincerely,

L. L. COLBERT.

MEMORANDUM

In the course of the Senate Finance Committee's inquiry entitled "Investigation of the Financial Condition of the United States," Senator Byrd, chairman, has submitted a list of topics to business leaders and others, for their comment. This memorandum discusses specifically item No. 6 of this list.

6. (*a*) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

1. Price stability.
2. Stability of production, demand, and employment.
3. Economic growth in production, demand, and employment.

INTRODUCTION: OLD RELATIONSHIPS BUT NEW RELATIVE IMPORTANCE

Economic growth is achieved when there are more jobs, more goods, more services, and more dollars of real income for more people. Distinct from growth is stability, which might be thought of as the tendency of the economy to remain in a specified relative position, for example, at full employment. Stability fundamentally means the avoidance in the economy of major economic disturbances and fluctuations in demand, prices, and employment at the same time the economy is

experiencing growth. Stable economic growth can be achieved if the economy possesses flexibility. The economic decisions which permit and even stimulate growth are made by the business firm, and it is here fundamentally that flexibility must be maintained. Flexibility means that employment, production, incomes, and prices adapt relatively quickly to competition, to invention, and to innovation. In our economy, most of this adaptation occurs in the market place through the combined influence of demand, supply, and prices.

When all three exist—flexibility, stability, and growth—then there is adaptation to change in such a fashion as to be compatible with full employment, high production, and stable dollars, as well as with more jobs, more goods, and more purchasing power.

It is unlikely that in the next few years new and hitherto unsuspected economic relationships will be discovered between stability and growth, or stability and flexibility, or among the various sectors where stability is a concern—prices, production, demand, and employment. But it is likely that there will be changes in the relative importance businessmen, political leaders, economists, and other interested persons will devote to prices, production, demand, and employment. These changes will call for new criteria to evaluate economic goals and to appraise the contributions of monetary and fiscal policies to achieving them.

THERE HAVE BEEN CHANGES IN THE CONDITIONS AFFECTING STABILITY

The trend of postwar experience suggests that consumers' markets are in a transition period. When the war ended there was no problem in persuading people to buy, for people had plenty of cash, high and secure incomes, and stocks of wornout goods. A lot of wornout stocks had been replaced by the early 1950's. In automobiles, for example, the seller's market became a buyer's market during 1953. Today it is difficult to think of a consumer's item that is not in a buyer's market.

Since the early fifties various market forces have helped to sustain expanded markets. For example, on the side of demand there has been the continuation of high marriage rates, high birth rates, and rising real incomes; while on the side of supply there have been new and improved products to attract customers. Also acting as an expansionary force have been alterations in the terms of sale. Houses are an example of how this latter influence has increased in importance. In the past several years changes in the downpayment, the length of terms, income requirements for potential buyers, and so forth, have all helped sustain the market. In general this is true for most products. The result has been more widespread ownership and a lower average age for consumers' stocks of goods.

However, there is a limit to the process of assisting markets by merely changing the conditions of sale. A product cannot be sold for less than nothing down, for example, or can credit soundly be extended beyond some fraction of the useful life of the product.

As more and more products approach this limit, then other ways must be found to maintain vitality of demand in the huge markets of our economy. One possibility is to devote more time and money to research and to the development of new products, new processes of

production, and more modern techniques of marketing. Hence investment increases in importance.

CHANGES IN ECONOMIC CONTROLS

Obviously, it is usually more difficult to maintain or increase sales by creating new products or new processes than by satisfying backlogs of demand or by stimulating demand through changes in the terms of sale. This is why we may expect to face domestic economic problems of the next several years in achieving vigorous yet stable demand, production and employment, as well as stable prices. While there may be no less concern with stability of prices, other problems will appear which may well take on substantially greater importance than at present. In such an event monetary and fiscal policies will be given broader goals than they have had.

For example, it may be that our tax system in the postwar period has not been adequate to cope with inflationary pressures, in that it has tended to influence the decisions of consumers, business, and labor in ways not conducive both to growth and stability. Our tax system should be designed to foster prosperity in an economy where the markets are buyers' markets. The importance of sustained high levels of consumer demand over the next several years calls for careful review of excise tax structure to eliminate discrimination and market strictures. For while relatively high excise taxes can be useful in a demand-inflation economy to hold consumption within the limits of productive capacity, lower excise taxes are needed when the emphasis shifts to stimulating consumption so productive capacity will not be idle.

THE IMPORTANCE OF MARKETING: DEMAND AND EMPLOYMENT

A recent study by the Department of Commerce indicates that the rate of growth of many markets has been slowing, implying a slackening in the demand for additional productive capacity. In their study the Department of Commerce classified products on the basis of rapidly growing, moderately growing, and declining products. In general, most products experienced high growth rates in the period 1940–51. Since 1951 there has been a definite slowing down in output expansion of many fast-growing products. In the moderately growing industries production of about one-half of the products grew less rapidly in the middle fifties than during the preceding years. In the declining industries the rates of decline have become somewhat greater since 1951. These changing growth rates point to the areas of difficulty likely to be met in achieving stable production and employment at high levels over the next few years. This consideration in turn underscores the crucial role investment, product innovation, marketing, and distribution must play if mass production for buyers' markets is to continue to be stable at large volumes.

It is undoubtedly more difficult to sustain growth in markets than to control prices, for price is only one aspect of a sale, not the sale itself. Sustaining market growth in our economy is also more important, from the point of view of employment, for men may be employed whether an inflation-control program works or not, but they

cannot continue to be employed if markets fail to expand, or if the labor force is growing faster than the demand for goods.

PRODUCTIVITY

A shift in the relative difficulty of achieving price stability and stability of production places the issue of improvement in productivity in a somewhat different light. Over the past few years we have become accustomed to thinking of these improvements as a safeguard against inflation since they tend to offset some of the excesses of demand over supply. Now there is developing increasing concern over productivity as an offset to costs. This concern is bound to grow.

As productive capacity expands in the years ahead and as buyers' markets become increasingly competitive high costs will be less tolerable than ever. To a greater extent than ever before companies are going to have to find offsets to increases in costs, as well as find ways to reduce costs, if they are going to stay in business.

Obstacles to increased productivity must be removed in the interests of high-level stability in demand, production, and employment. More constructively, improvements in productivity must be fostered. Greater productivity is the result of investment in technological advances, increased mechanization, more efficient use of materials, and improved distribution methods, as well as of a more skilled labor force and an increased recognition by labor that management and labor have interests in common. Clearly, it is important to stimulate business incentives to invest, invent, and to innovate. Full consideration ought to be given to strengthening the individual entrepreneur's confidence in the prospects for private business.

CONCLUSION: ECONOMIC POLICY IS FOR THE FUTURE

We are entering the third stage of postwar economic history. In the first stage pent-up demand was satisfied. In the second stage total demand was sustained partly by changing the conditions of sale. In the third stage new stimuli must be found or old stimuli cultivated more intensively to maintain growth in consumption and reduce costs.

Relatively lower costs of production, and greater efficiency in marketing must constitute a large share of manufacturers' skills over the next few years. This involves greater productivity through investment, invention, and innovation, and greater trade volume through improved marketing methods, within the framework of a tax system which strongly encourages individual initiative.

It would be a mistake to try and adjust our economic polices merely in the light of any real or imagined failings of the last few years. The economic policies appropriate to guide an economy such as ours must preserve freedom, increase economic opportunity, and reward individual initiative. They must reflect major economic facts anticipated for the years ahead, as well as significant past events.

Developments in the relative difficulty of realizing price stability and stability of production mean increasing challenge to legislators, administrators, and businessmen. The tasks ahead may well be more complex than in the past, but we know that the rewards of a stable and growing free economy make the effort eminently worthwhile.

GENERAL ELECTRIC CO.,
New York, N. Y., May 2, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate,
Washington, D. C.

DEAR SENATOR BYRD: In accordance with my telegram to you yesterday I am attaching herewith a statement on, "The Financial Condition of the United States." This is in reply to your letter of February 17 and the questionnaire.

I regret that I have not been able to complete this statement at an earlier date. The delay is due, in part, to securing the collective thinking of the senior officers of General Electric Co. as well as the company's economists and financial advisors.

You will note that for the ready reference of yourself and your staff my statement has been classified as follows:

Introduction.
Objectives of a sound economic policy.
The structure of built-in inflationary pressures.
Wage inflation—the root of the trouble.
Fiscal policy.
Monetary policy.
"Creeping inflation" would mean runaway ruin.

Knowing your interest in contributions and sound leadership, as Chairman of the Senate Committee on Finance, I consider it a privilege to submit to you, and through you to members of your committee, my personal philosophy on these vital issues.

With kindest personal regards.

Sincerely,

RALPH CORDINER.

STATEMENT OF RALPH J. CORDINER, CHAIRMAN OF THE BOARD, GENERAL ELECTRIC CO., ON THE FINANCIAL CONDITION OF THE UNITED STATES

INTRODUCTION

The financial condition of the United States is a matter of continuing concern for business managers because of its dominating influence on the economic environment in which business organizations operate. Changes in national economic policy directly affect business operations and the changing abilities of individual businesses to live up to their full usefulness to the public profoundly affect the development of the economy as a whole.

It is therefore part of the responsibility of a business manager to develop and maintain an informed viewpoint concerning the necessary and desirable objectives of national economic policy and the means by which these objectives can most appropriately be pursued. It is his further responsibility to make this viewpoint widely known to the

public and the public's representatives in Government for their guidance in maintaining and strengthening the kind of economic environment in which business can most successfully serve the general good.

In the following comments the objectives of a sound economic policy and the available means for pursuing them are defined with reference to the 17 questions raised by the Senate Finance Committee in its inquiry entitled "Investigation of the Financial Condition of the United States."

OBJECTIVES OF A SOUND ECONOMIC POLICY

The basic problem raised in this inquiry is that of achieving an appropriate balance between the objectives of economic growth and stability. Both are inherently desirable and neither can be achieved without the other, but either objective may interfere with the other if carried to excess. Only through an appropriate balance of economic growth and stability can the Nation achieve the optimum levels of employment and optimum utilization of all economic resources which are the proper aim of economic policy.

The starting point for consideration of these objectives is the need for economic growth. The population of the United States is steadily increasing and the American people legitimately insist upon ever-rising levels of living. The result is a consistent increase in the demand for goods and services, which calls for a corresponding growth in the volume of production. A harmonious relationship between the growth of demand and the increase in production and employment can only be achieved if there is realistic understanding of how our competitive economy functions—and thus how wise economic decisions can be made—on the part of consumers, workers, savers, and their representatives in Government, unions, and other organizations.

A satisfactorily growing volume of production connotes a continuing increase in the number of men and women able and willing to do the work; in the number, size, and efficiency of the Nation's productive facilities; and in the amount of capital funds invested in productive enterprises. A rate of production increase sufficient to insure rising levels of living also requires continual technological innovations and improvements in the art of business management.

These are variable factors with constantly shifting relationships. No economist or statistician, by observing the activities of all the men and women in the United States, could determine the exact relationship existing at any given time between these factors, nor the exact relationship which would be required to produce the ideal balance of economic growth and stability.

Nor are these factors subject to arbitrary control, since they vary according to the individual decisions of millions of citizens, decisions which must in many instances be made long before their effects on the economy can be known.

In a free society, each individual decides for himself where to live and what kind of employment to seek, what to buy and what not to buy, how much of his money to spend and how much to save, how much of his needs to meet from current income and how much by borrowing. Each employer and each employee is more or less successful in his work according to the skill, care, and effort he puts into his job, the wisdom of his decisions, and the ability with which he conducts his relationships with others. The innovations which result

from research and development work, whether in the technology of production or the art of business management, cannot be predicted in advance. No scientist can foretell exactly when his work will bear friut or what its effects on the economy will be.

Therefore in a free and dynamic economy, no mechanical system for controlling or stabilizing the rate of economic growth can hope to succeed. Continual adjustments of prices, production, demand, and employment must take place in individual sectors of the economy through the interaction of these millions of decisions made by individual citizens in the course of their daily lives.

New products will displace old ones; changes in consumer needs and wants will promote the growth of some industries and cause the decline of others; growing businesses will draw customers, employees and capital away from obsolescent enterprises. In the long run, our success in maintaining economic growth and stability will be largely influenced by the wisdom and sense of responsibility with which these economic decisions are made and the resulting adjustments are carried out by the individuals concerned.

As long as these adjustments are in approximate balance, with some prices falling as others are rising, and new employment opportunities opening up as others disappear, the overall stability of the economy is not appreciably disturbed.

However, this ideal balance has rarely, if ever, been achieved, nor is perfection ever likely to be attained. The upward and downward trends in different sectors of the economy, in prices, wages, interest rates, employment, productivity, and profits, are not always in balance. Under certain circumstances their effects tend to be cumulative rather than corrective, leading to inflation when the general movement is upward, and deflation accompanied by recession or depression when the movement is downward.

The aim of policy therefore should be to discern as promptly and accurately as possible which trends are acting correctively at any given time, and operating in the direction of growth and stability; and which trends are working in the opposite direction. Sound corrective trends should at all times be encouraged by economic policy, and the opposite trends discouraged. Timely use of preventive measures offers the best hope of avoiding the violent upward and downward swings of the economy which require emergency measures by the government of a more massive and therefore more dangerous character.

Our basic problem is that we are, fortunately, a very well-to-do country. Citizens at every level do most of their buying to satisfy extra desires well beyond any actual needs for survival or subsistence. In such a situation, any conclusions we draw from purely mathematical evidence must be modified by consideration of emotional factors such as the attractiveness of products and the confidence in the future that influences people's decisions to buy. Most purchases can be put off, and many need not be made at all.

There are, in our judgment, two basic obstacles to success in tempering the upward and downward swings of the economy. First is the difficulty of discerning far enough ahead and with sufficient accuracy the changes in direction of the economic trends we have mentioned. This is largely a question of further progress in the sciences of market research and of economic research, analysis and psychology. We

can confidently expect additional understanding of these subjects to be achieved in time with the continued application of effort and intelligence.

The second basic obstacle to success is the widespread popular misunderstanding of the nature and effects of inflation, and the misguided notion that measures which result in inflation provide a simple cure for unemployment and other economic ills. This beguiling error leads to continual political pressures upon the government to exert its economic influence in the direction of inflation rather than stability and sound growth. This same misunderstanding, and the long-range inflationary trend which flows from it, are also the continuing source of other errors of economic and political judgment on the part of millions of the decisionmakers who determine the course of the economy.

THE STRUCTURE OF BUILT-IN INFLATIONARY PRESSURES

No single influence on the economy of the United States has a more unstabilizing effect nor is more inimical to orderly growth than the structure of built-in inflationary pressures which have been tolerated and in some respects created and encouraged by government policy. By inflation, we refer to a condition of generally rising prices, characterized by an excessive level of effective demand for the available supply of goods and services. Such a condition has existed in the national economy in most years since the end of World War II, and has acted as a major contributing cause of the current recession.

During these years of inflation, the levels of production, employment and demand were high and generally rising. Individuals, businesses, and the Federal, State and local governments were using a swollen supply of depreciated dollars to bid against each other for the limited supply of economic resources. The inevitable effect was the upward pressure on prices we have seen.

Under such conditions, the volume of money which individuals, businesses, and governments saved out of their incomes by curtailing expenditures could not be as great as the volume required for investment in the expansion and improvement of productive facilities and the establishment of new productive enterprises. The shortage of savings was made up by the expansion of credit, which had the effect of adding further to the Nation's money supply.

The generally optimistic attitude engendered by the continuing increase in effective demand encouraged producers to expand their capacity as long as it appeared that economic growth would continue uninterrupted, and profit incentives would therefore justify the investment.

Underlying this optimism, however, was an awareness that an inflationary spiral could not go on forever, and that the longer it lasted the more damaging it would be. Once such a spiral is set in motion, it tends to feed on itself. The expectation of further rises in the price level and corresponding declines in the purchasing power of the dollar encourages people to buy even further ahead of their needs or usual desires, and to spend more of their income and save less of it. The gap between the supply of savings and the demand for investment funds becomes greater, leading to further expansion of credit. Consumers with rising incomes tend to buy goods before they need

them or would normally want them, while those with fixed incomes tend to buy fewer goods because of the rise in prices. Businesses are encouraged to anticipate growth requirements, and to engage in long-cycle construction and expansion programs to build up their inventories too far ahead of needs.

Early last year the rise in interest rates, resulting from the growing excess of demand for investment funds over the supply of savings, serves as a warning to the economy that the inflationary spiral was gaining dangerous momentum. Consumer resistance to rising prices had already begun to appear in some sectors, notably housing and consumer durable goods.

Business responded by cutting back some of its expansion plans, as it began to appear that the rate of growth would be slowed, halted, or temporarily reversed. The effect was promptly felt in the capital goods industry, which was obliged to cut back production. Liquidation of inventories became general, leading to wider temporary cutbacks in production. The outlook of businessmen and consumers shifted from excessive optimism to caution and uneasiness, leading to further postponements of expenditures and a further decrease in overall demand.

What were the inflationary pressures that had created this situation? Psychology was one of them—a general tendency to err on the optimistic side in economic judgments. Government fiscal policies had something to do with it—based on our unwillingness as a nation to recognize that money spent by the government is not the government's money but the people's money, and cannot be spent by both the government and the people at the same time without losing its value. Federal monetary policies had something to with it, for the measures taken to restrain credit did not prevent the level of expenditures from expanding more rapidly than the volume of goods and services available for purchase.

WAGE INFLATION—THE ROOT OF THE TROUBLE

The greatest of the inflationary pressures, however, is the wage-price spiral which has been characteristic of the years since World War II, and is still going on. The driving force behind this spiral is the monopoly power of unions, which has been created in large measure by Federal policy and legislation, and which enables the unions to obtain excessive wage increases by threatening the destruction of any business which refuses to agree. Once granted by a major company, such wage increases tend to spread to other companies and other industries, and to result in higher prices which lead to another round of demands for wage increases. Escalator clauses compound the evil by making these effects automatic, while attempting to protect those who caused the trouble from the ill effects of their errors.

In any period of vigorous economic growth, with high and rising levels of production and employment, the natural tendency of wages is to rise in response to the growing demand for labor. If the productivity of the economy is also increasing at relatively the same rate, a concomitant increase in the general price level or a decrease in the profits accruing to the economy as a whole. Investment of these

profits in further expansion of the volume of production and further improvements in productivity will permit continued high levels of employment and continued substantial wage increases.

Inflationary pressures arise, however, when excessive wage increases push the general wage level higher than the economy can sustain without either a rise in the general price level or a decrease in the profits which provide the investment funds needed for further economic expansion. Unfortunately the exact level at which wage increases become excessive cannot be determined precisely in any individual instance, either by Government administrator, union leader, or business manager. It must be worked out through the bargaining of the parties concerned, in the light of economic conditions. When the bargaining is done collectively, both parties must be adequately informed and of equal strength at the bargaining table. The degree of success achieved in the public interest will reflect the flexibility with which both sides adjust their decisions to the shifting forces at work in the economy.

Unfortunately, the existing labor laws and continued misunderstanding on the part of the general public give union leaders the dangerous illusion that their privileges protect them from the operation of economic laws. By carefully planning their strategy of strike threats, they can compel business organizations to yield individually to inflationary wage demands going far beyond the limits of economic reality.

In consequence, the upward pressure on wages arising from high levels of employment has been multiplied by union power to the magnitude of an irresistible inflationary pressure. In recent years an outlet was provided for this pressure by a combination of Government fiscal and monetary policies inadequate to prevent inflation. The presence of inflationary money and credit in the economy permitted businesses for a time to pay the excess wage costs by passing the burden on to the consumers through increased prices. The consequence was to stimulate the wage-price spiral, postpone the day of reckoning, and thereby insure that the reckoning would be more costly when it came.

On the other hand, the experience of the last 12 months show that monetary controls cannot by themselves prevent excessive wage demands. Credit restraints may stiffen consumer resistance to higher prices, but they did not eliminate union pressure for higher wages. The resulting higher costs have led only to a net decrease in demand, production and employment, and the primary burden has fallen on the wage earners who have lost their jobs.

There is no way to prevent excessive wage increases from having these effects. When prices are raised in the face of consumer resistance in order to cover excess wage costs, sales volume falls off, production has to be cut back, and employees are laid off. When excess wage costs are absorbed out of profits in order to maintain sales volume by keeping prices down—a process that can absorb only very small wage increases and then only for a very short time—the effect is to reduce the funds available to businesses to buy capital goods for expansion and improvement, and to the owners of businesses to buy consumer goods. The result is the same—a decrease in total demand that requires production to be cut back and workers to be laid off.

Both these processes can be observed at work today in different sectors of the economy; in combination with the unrealistically high farm prices resulting from the farm support program, they help to explain the continued rise in the general price level in the face of the current recession.

Union officials do not appear to be concerned with protecting the economy from inflation. They disclaim responsibility for the inflationary effects of their excessive wage demands, and seek to shift the burden to other groups in the economy. They claim special protection for their members, in the form of escalator clauses to provide automatic wage increases to offset the tax of inflation which shows up in the increasing cost of living, and they demand further inflationary increases in pensions, insurance, and other benefits. They seek political support by demanding increased social security and unemployment benefits to make up for the declining value of the dollar, and a topheavy tax structure which reduces their share of the inflated costs of Government. Relying on these special privileges, they ignore the fact that the wage earners suffer more than any other group from the periodic recessions that come from inflation, because they bear the primary burden of unemployment.

When Congress originally granted union officials the privileges on which their monopolistic powers have been built, the Nation consented in the hope that these powers would be used with such wisdom and sense of responsibility as to contribute toward greater economic growth and stability. Experience has shown, however, that these powers have been abused in an irresponsible attempt to gain special privileges at the expense of the Nation as a whole, while the penalty for these abuses has fallen most heavily on the group which was presumed to benefit from them.

It is abundantly clear that by these abuses the union officials have forfeited whatever right they may ever have claimed to the enjoyment of such special privileges and immunities. Curbing the monopoly power of unions is a necessary first step if the economy is to be effectively protected against the cycle of inflationary spirals and business recessions, by the use of sound Government fiscal and monetary policies and the exercise of sound business judgment.

In the meanwhile, the current fiscal and monetary policies need to be adjusted in the light of the forces currently at work in the economy, both short- and long-term. The present recession is primarily a corrective swing following the inflationary excesses and related economic imbalances of recent years. It is largely confined to the durable goods industries, and has not yet developed into an uncontrolled deflationary spiral such as would lead to a deep and prolonged depression. Nor does it appear that there is real danger of such a development.

Therefore Government measures to combat the recession should be limited to those required for the direct relief of the unemployed, and for counteracting such deflationary forces as may be temporarily in evidence. Care must be taken to avoid dampening the recovery, to minimize the inflationary aftereffects of these antirecession measures, and to direct fiscal and credit policies toward economic stability rather than inflation as soon as recovery is well underway.

FISCAL POLICY

The fundamental objective of fiscal policy at all times should be to provide the Government with the money it needs to perform the services which individuals and business organizations cannot perform themselves, with a minimum of interference to the economy. The operations of Government fiscal policy inevitably affect the civilian economy, because nothing can be bought by the Government which is not produced by the people, and no money can be spent by the Government which is not provided by the people. These simple principles are too often overlooked by those who believe that management of the national economy is the primary purpose of fiscal policy, and who do not realize that the effects of fiscal policy must be carefully controlled so as to help rather than harm the economy.

Deficit spending during the current recession, for example, may be to a certain extent unavoidable, since the decline in business activity automatically reduces tax revenues, without reducing the necessity for many of the Government expenditures. However, the deficit must be vigorously limited in order to minimize the resulting inflation. The acceleration of spending on certain defense and public works projects temporarily contributes a corrective effect, and avoids the necessity of spending the same money during the recovery period when it would have more dangerous inflationary effects. Where the timing of Government expenditures is subject to flexible adjustment, it is obviously better for the Government to spend money when the civilian demand is at its lowest and avoid spending it when civilian demand is relatively high, but public servants will not be enabled to do the latter until public understanding has improved.

New spending projects specifically designed as antirecession measures must be most carefully scrutinized. Wasteful and unnecessary spending is no more helpful to the economy in bad times than in good times. Plans for spending money later will not help the economy now; on the contrary, current Government planning should be directed toward preparing to limit the growth of expenditures as soon as the economy turns upward.

Proposals for cutting taxes as an antirecession measure must also be resisted. A so-called tax cut without an equivalent cut in Government spending is not a tax cut at all, but merely a shift from visible tax collection to the invisible tax of inflation.

In the long run, correction of current deflationary trends is a less difficult problem than correction of the long-run inflationary trends resulting from current and recent fiscal policy. Budget surpluses sufficient to permit orderly but substantial reduction of the national debt will be an essential requisite for successful control of inflationary pressures once the current recession yields to recovery.

The level of Government spending has been for years swollen by unneeded services, unwise expedients and overgrown bureaucracy. As the economy grows, it will be better able to support the high level of expenditures which may be required, especially for defense. However, even a growing economy cannot support a continued increase on the present scale without suffering either renewed inflation or an intolerable burden of taxes, along with a dampening of the productivity of the freely competitive market.

When recovery from the current recession is well underway, the opportunity will present itself for reducing the scale of Government spending, and plans should be made now to take advantage of this opportunity. Two major areas for reduction come immediately to mind. One is contained in the recommendations of the Hoover Commission, which have already resulted in important savings. Further steps remain to be taken along the lines of returning to private enterprise those operations which it can perform more efficiently than the Government; and eliminating wasteful procurement of military supplies through a unified defense procurement administration.

The second area of Government spending offering even greater room for improvement is the farm price-support program. Certainly everybody wants the farmer to be treated with equity and every human consideration. But a country as resourceful as this should certainly be able to devise a vast improvement over the means currently used. The present farm program keeps millions of farmers doing unneeded work, creates huge and internationally embarrassing surpluses, raises the price of food and clothing to needlessly uneconomic heights, and inflates the cost of living index which triggers the escalation clauses of wage contracts. Thus it raises the prices paid by everybody, including farmers, and causes large Government deficits which add to the inflationary pressures.

Another aspect of fiscal policy which deserves immediate attention is the present structure of personal and corporate income taxes. High corporate income taxes are inflationary in themselves since they represent a cost to business which tends to be reflected in pyramiding price increases. Inadequate depreciation allowances for tax purposes deprive business of the funds needed for investment in the improvement and expansion of productive facilities and the formation of new productive enterprises. High and steeply progressive personal income taxes deprive individuals of both the incentive and the funds for risk-type investments in the Nation's economic growth.

The effect of the tax structure is to reduce the volume of savings and capital formation on the part of business and individuals. In prosperous times the demand for savings is subject to the same upward pressures as the demands for goods and services; and if the supply is inadequate, the shortage is made up by the expansion of credit, and thus the furthering of inflation.

Long-range reforms of the tax structure require a great deal of study, and it cannot be said that the perfect solution has yet been found. However, the approach represented by the Sadlak-Herlong bill, which would gradually scale down the most damaging progressive rates of both personal and corporate income taxes, and at the same time impose a control on Government spending, offers an appropriate starting point for such a study. The present discriminatory system of excise taxes also deserves study, with a view to broadening the base, establishing greater uniformity of rates, and making the specific amount of the tax paid on each purchase more plainly visible to the buyer.

Another long-range reform for which planning could well begin at this time is the transfer of as many Government services as possible from the Federal to the State and local levels. The construction of schools, highways, and public buildings by the Federal Government

not only removes the spending authority from the control of the taxpayers in the locality in which the money is spent, but it adds to the inflationary potential of the public debt. Deficit spending by the Federal Government is too largely financed by short-term securities through the credit expansion facilities of the commercial banks and thus creates inflationary pressures. State and local governments, however, resort to long-term financing that must meet more critical tests of the financial markets.

MONETARY POLICY

During the current recession, the stimulus to credit expansion provided by financing the deficit through commercial banks may have the somewhat useful effect of counteracting the temporary deflationary pressures which complicate the problem of recovery. When the recovery is well underway, however, the proportion of bank financing should be reduced in order to combat the inflationary pressures which will then reassert themselves.

Progress in reduction of the national debt, already suggested as an objective of fiscal policy during the coming period, would contribute toward this end. In addition, inflationary pressures could be lessened by refinancing part of the outstanding national debt now held by commercial banks and replacing it with long-term securities, sold to nonbanking investors. While this procedure may increase the cost of servicing the national debt by committing the Government to relatively high interest rates over an extended period, the cost would be much less than the inflationary increase in all the costs of Government that accompanied the failure to follow this policy during the years 1955–57.

The credit controls operated by the Federal Reserve System, through open market operations and the adjustment of rediscount rates and reserve requirements, have worked more satisfactorily since the Reserve discontinued the policy of pegging the market price of Government securities in 1951. Prior to that time, the willingness of the Reserve to buy such securities at a fixed scale of prices largely surrendered control over back reserves into the hands of holders of Treasury obligations.

Since the accord with the Treasury, the credit policy of the Reserve has been administered with as much success as can reasonably be expected. The complexity of forces operating on the volume and velocity of credit circulation are such that the timing and effectiveness of Reserve actions cannot always be perfect. However, on balance it would appear that the problem would be made more difficult rather than easier if the scope of Government credit controls were enlarged.

It is particularly important to avoid any attempt at direct control over consumer credit, which has proved itself sufficiently responsive to indirect control through the commercial banking system. To interfere directly with the terms on which consumers make these purchases would be to upset the operation of the free economy in much the same way as price and rationing controls did during the war.

CREEPING INFLATION WOULD MEAN RUNAWAY RUIN

From these considerations it is clear that the Government would contribute more effectively to the growth of the economy, and to reduc-

ing the frequency and severity of economic recessions, if its fiscal and credit policies were directed toward more vigorous support of economic stability and less encouragement to inflation.

Too much credence has been placed by the Nation's policymakers in the mistaken concept that a gradual inflationary trend, sometimes known as creeping inflation, should be accepted as necessary and desirable in order to achieve and maintain full employment goals. Nothing could be further from the truth.

If creeping inflation were accepted as a permanent feature of American economic life, it would not create jobs; it would only feed on itself in a rising spiral of costs and prices. To accept creeping inflation instead of using every possible means to combat it would be to apply to our economy the greatest of all inflationary pressures—the pressure of inflation psychology. Expecting continued prices increases, businesses and individuals would have a continuing incentive to spend their money before its value depreciated further, and would thus be tempted into a flight from money. The inadequate volume of purchasing characteristic of the current recession would be replaced by an increasingly excessive rate of spending, with far more destructive effects. The volume of savings would continually diminish, cutting off the only real source of investment funds. The efforts of businesses to continue expanding the volume of production and improving the attractiveness of their products, so as to maintain high levels of employment, would require continued expansion of money and credit. Thus the inflationary spiral and the profitless prosperity would be accelerated toward inevitable collapse.

The effects of supplying such a flight-from-money temptation would thus be not to promote greater employment but greater inflation, and creeping inflation would rapidly become runaway inflation. This is the true nature of the danger now facing the Nation.

It is true that high and rising levels of employment may, if national policy permits, be accompanied by inflation. Such inflation should not be mistaken for a cause of full employment, but should be recognized as an effect of misguided policy. As such it must be combated by public support of appropriate measures to curb the monopoly power of labor, cut down unnecessary spending, and reform the tax structure, in order to permit the continued economic progress which the people of the United States justly demand.

GENERAL MOTORS CORP.,
Detroit, Mich., March 24, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States, Senate, Washington, D. C.

MY DEAR SENATOR BYRD: In this letter I shall endeavor to give you my thinking with respect to the vital matters affecting our economy detailed in the questionnaire accompanying your letter of February 17, 1958. Noting the long list of persons to whom you have addressed similar letters, many of them experts in various fields, I have concluded that I could be most helpful to you if my observations were confined to subjects which I can discuss on the basis of my own knowledge, observation, and experience. I have adopted your suggestion that the questionnaire be used merely as a guide and have arranged my material to give it some degree of cohesion and continuity. The only questions I have not answered directly are those relating to the monetary and fiscal policies of the Federal Government.

I. UNITED STATES ECONOMIC GOALS

Most people agree, I believe, that a country should have certain goals or objectives toward which it should strive. These long-term goals provide the basic criteria by which to evaluate short-term problems and judge proposals for their solution. Most of us also would agree that the economic objectives mentioned in your questionnaire—(1) price stability; (2) stability of production, demand and employment, and (3) economic growth in production, demand, and employment—are among the most significant goals of a free economy.

Perhaps I should explain my interpretation of the word "stability." I would define "price stability" as the maintenance of a level trend of the price averages. On the other hand, I do not envision "stability of production, demand, and employment" as a leveling of these factors. Stability in this context means the avoidance of serious interruption to a rising trend—in other words, steadiness.

Ideally, no priorities should be established in seeking these three goals. We should strive to achieve a high rate of economic growth with a minimum of cyclical instability in production and employment and with a stable price level.

We must recognize, however, that all three goals are interrelated and can be in conflict at any given time. Our experience in this country, as well as that of the free nations of Western Europe, has been that if one or perhaps two of these goals are achieved for a period of time, it is at the expense of the others or other. A period of rapid economic growth is likely to be accompanied by increasing prices and be followed by a period of recession. On the other hand, a period in which prices are stable is not usually a period of growth. If too much emphasis is placed on eliminating fluctuations in production, demand

and employment, growth probably would be inhibited and prices would rise.

Opinions may differ as to the priorities that should be attached to these objectives of national economic policy. This in turn affects the evaluation of current trends and the approach to current economic problems. In the United States we have tended to give priority to economic growth. Historically, we have been successful in achieving a high rate of growth and a rising standard of living, but at some cost in terms of stability.

In my opinion, this has resulted in the greatest good for society. Ranking all three of our objectives of economic policy, I would place them in the following order of priority:

1. Economic growth in production, demand, and employment.
2. Stability of production, demand, and employment.
3. Price stability.

ECONOMIC GROWTH

There are many reasons for assigning first priority to economic growth. Both our population and our labor force are increasing. We can look forward with assurance to a continuation of these trends. If we were to do no more than provide the present standard of living for future generations, total annual output would have to increase.

Americans, however, have never been satisfied with such a limited goal. The desire for a higher standard of living broadly diffused through all parts of our society has been a driving force in our economy. Accordingly, if we are to meet national needs, the first essential is an economic framework which encourages economic growth and stimulates and rewards the investment on which our growth so directly depends.

While I believe that improving the standard of living of all our citizens is a sufficient reason for attaching first priority to economic growth, there are also other important reasons. As a nation, we are allocating a substantial portion of our effort to military defense. If, as now seems likely, our defense budgets are increased, the maintenance of a substantial rate of economic growth is even more urgently required.

Economic growth is necessary to provide investment opportunities for savings. Growth is also necessary to insure the most efficient use of our labor force under conditions of rapid technological advance.

STABILITY OF PRODUCTION, DEMAND, AND EMPLOYMENT

The maintenance of stable employment and production at high levels was established as national policy in the Employment Act of 1946, with responsibility assigned to the President to recommend action to the Congress to insure that this policy is made effective.

A problem arises, however.

Let us agree that prolonged periods of depression make it impossible to achieve a high rate of economic growth. On the other hand, some sectors of the economy are bound to move ahead faster than others, and the very processes of growth have periodically resulted in temporary imbalances as between inventories and sales or capacity

and consumer demand. Typically, recessions in the United States have been of short duration and have served as periods for making essential readjustments in inventories and in the allocations of labor and capital.

The problem is one of providing the economy with the opportunity to make these essential readjustments as a basis for further growth, at the same time taking steps to assure that the decline in economic activity does not gain momentum and thus retard growth. To those who might suggest that the problem rather is to make such readjustments unnecessary, I would say that a solution to the problem so stated would of itself inhibit growth.

There is, however, in this area a proper role for Government to play. At a later point I would like to suggest Government action appropriate to the current recession.

PRICE STABILITY

The problem of maintaining a high rate of economic growth with full employment and also of maintaining price stability is extremely complex. The period since the close of World War II well illustrates this.

The period has been, first of all, a period of rapid growth to meet the more pressing deferred needs of the Nation. Our industrial base has been significantly broadened, and the level of living of our population has been increased. Much more remains to be done, but this in no way detracts from the outstanding accomplishments of American industry during the past 10 years.

The decline in the purchasing power of the dollar has been the second significant postwar trend. There is general agreement, I believe, that, in the postwar period through the Korean war, the price inflation was primarily the result of an intense demand for goods of all sorts, coupled with an increased supply of money arising out of our war financing. In the past 2 or 3 years we find no grounds for attributing the inflation to these factors.

I believe the principal inflationary factor in this period has been the leverage that powerful labor unions have been able to exert on wage rates and particularly on fringe benefit costs as a result of labor shortages caused by high-level employment. The increase in labor costs has been much greater than the increase in national productivity. Union power, unrestrained by the antitrust laws, is now greater than ever before.

This growth of power is not a new trend. What is new is the full realization of the economic effects of legislation enacted some 20 years ago.

There are few who would argue that inflation in any significant degree is desirable. Whether a full-employment policy necessarily implies price inflation depends in part on the degree of union power which our society is willing to tolerate. There is also the question of what we mean by full employment.

If it is our national policy to "shore up" every local area of unemployment and to strive for such a high level of employment as to create chronic labor shortages which unions can exploit, trends of the past 3 years suggest the direction in which we shall continue to move. A certain amount of flexibility of both labor and capital is

essential to the efficient allocation of resources in a free economy. A full employment policy that creates chronic labor shortages forces wages to rise faster than productivity and interferes with the efficient adjustment of our productive resources to the changing needs of our economy.

Our objective should be to set our full employment goal and our Government policies so as to facilitate, not interfere with, these socially desirable shifts. If we do this and if we take action to establish a balance of power between unions and management, I believe there is a reasonable chance that long-term stability of price levels may be achieved.

II. Current Economic Trends

The present recession developed out of a major capital goods expansion which followed a period of very active demand for new housing, automobiles and other consumer durable goods. The expansion had resulted from a combination of three factors: shortage of capacity, optimism over the prospects for economic growth, and the development of many new products and processes. Capital programs were accelerated by rising prices and the rising cost of financing.

The expansion came to an end as a result of the increased tightness of money and the completion of many projects. While the level of new capital investment remained high during most of 1957, the peak in new commitments had been reached early in the year. A factor that contributed to the downturn in business activity was the wage-cost push which began to squeeze profits. Still other contributing factors were: a sharp reduction in defense orders; a decline in demand for United States exports following a sharp rise in 1956 and early 1957 aggravated by the Suez crisis, and the start of an inventory readjustment as it became evident that there were no longer any shortages of raw materials.

As a result of these changes in the underlying trend of business, employment was reduced in some areas, and confidence was weakened. Consumer spending, especially for durable goods such as automobiles, was affected, and the pressure to reduce inventories increased. During the fourth quarter of 1957, the loss of confidence become contagious, and inventory reduction became a widespread policy. Finally, as the recession in industry gained momentum, the secondary effects of reduced employment and lower incomes began to be felt in a further curtailment of business and consumer spending. Many people adopted a "wait and see" attitude, and the drop in both business and consumer spending in many areas became greater than warranted by the loss of purchasing power.

Business recessions begin because of maladjustments or lack of balance in the various parts of the economy. It is characteristic of most recessions that they correct themselves. We must work against developments which destroy confidence and thereby needlessly prolong the period of correction. This period usually continues until balance is restored, but frequently there is an overcorrection.

A good example is inventory reduction carried to the point where inventories are too small to meet even the reduced demand existing during a recession. This almost guarantees the ending of the recession and the beginning of recovery, but it is likely to involve unnecessary unemployment.

Business and consumers, acting by themselves, are unlikely to resume spending in a recession until they have reduced their debts and have to buy to replenish depleted or wornout stocks or until their confidence in the future is restored. In a severe recession, their ability to buy is steadily reduced. At some point, therefore, it is necessary for the Government to take steps to restore confidence.

The present recession, as I have pointed out, has now reached a stage where some of the unnecessary secondary effects are beginning to be felt, even though the great majority of consumers are still working and earning and spending. The problem is to stop further overcorrection without preventing the adjustments which are necessary for resumption of sustained high-level production and growth.

Some reduction of inventories was admittedly required to correct an unbalanced position. In many industries capital investment cannot be resumed on a large scale until the market grows up to present capacity. This takes time. Meanwhile, however, there are other areas of the economy—particularly in the services and in new products—where there are still shortages of labor and capital.

The role of the Government, it seems to me, is to take steps to restore confidence and insure the maintenance of purchasing power while these necessary and desirable shifts and adjustments are taking place. It can do this, first, by appropriate monetary action, second, by accelerating authorized Government expenditure programs and, third, by lowering taxes.

The first steps have already been taken. The monetary policy of the Federal Reserve has been reversed to make money available for borrowing at lower rates. Various measures have been adopted or recommended to step up Government spending programs previously authorized.

The simplest and most effective move, in my opinion, would be to cut taxes across the board until the recession ends and the curve of business activity has clearly turned upward. Not only would tax reduction have the double advantage of speed and of providing more purchasing power without any immediate effect on costs or prices, but it would also have the tremendous psychological effect which is so necessary to restore confidence. Such a move would necessarily and properly require a further temporary increase in the debt limit.

By increasing purchasing power, Government action along the lines recommended above should not only generate renewed confidence but also provide an economic climate conducive to the free movement of labor and capital.

Finally, it is essential that nothing be done to discourage business investment in new products and processes, because it is in this area that the seeds for future growth are sown. Business has a responsibility to do everything it can to stimulate demand by bringing out attractive new products, by giving the consumer greater values and by aggregessive selling.

THE INFLATION-UNEMPLOYMENT PARADOX

A widely noted aspect of the current recession is the fact that the cost of living has continued to rise. I believe that the explanation of this seeming paradox that at times inflation and unemployment exist side by side in our economy lies in the critical factor of timing. In-

dustries in our economy do not experience increases and decreases in demand at the same instant; nor do various elements in the economy all change at once. There are varying time lags in the process of adjusting to a new set of economic conditions, some of them covering quite a long period.

The term "rolling readjustment" has been used to describe earlier recessions since World War II in which production in some industries was expanding and in others was declining. The current readjustment is being felt primarily in the industrial sector of our economy—in manufacturing and mining. Within this sector, producers of capital equipment and consumer durable goods have been particularly hard hit. At the same time, consumer expenditures for nondurable goods and services appear to have been well maintained. In the wholesale price index, there has been no increase, on the average, in industrial prices since the end of 1956, while farm products and foods have risen substantially. In the consumer price index, the price of services (which has no wholesale equivalent) has been rising steadily throughout the last 18 months. This is essentially the result of higher labor costs.

ESCALATOR CLAUSES AND PRICE STABILITY

General Motors, as you know, has had long-term agreements with unions representing its employes since 1948. These agreements include a wage formula consisting of a cost-of-living allowance to adjust the buying power of an hour's work in line with changes up or down in consumer prices and an annual improvement factor wage increase to improve the buying power of an hour's work in line with the average increase in the productivity of the country as a whole over the long term.

It is my belief that these so-called escalator clauses are neither inflationary nor deflationary. To the extent that the cost-of-living allowance is increased, this is a result of inflation not a cause. Wage increases granted by General Motors under the annual improvement factor serve to keep our employes abreast of the long-term increase in our country's standard of living.

There is another point I would like to make in connection with the improvement factor. Insofar as productivity does increase, it is achieved by technological progress, better tools, methods, processes and equipment and a cooperative attitude on the part of all parties in such progress. It is proper therefore that increased productivity be shared by our employes, our shareholders and our customers.

Quite aside from their monetary aspects we believe that our long-term contracts have been beneficial in many ways. They have freed our employes from the threat of strikes for the full term of these longer contracts; they have assured our plants of a dependable work force and our customers of a continuous flow of products. In dealing with large unions, it has been our view that this arrangement is better than to have short-term contracts which, lacking escalator clauses, keep the workers, the management and our customers in a state of uncertainty and unrest. It is doubtful that wage rates would have increased any less had we followed this latter practice. Thus, it is our conviction that our employees, our shareholders, and our customers have all benefited from these long-term contracts.

THE EFFECT OF PRIVATE DEBT ON STABILITY

There is nothing inherently wrong about debt if it is incurred wisely. In some instances it results in an improvement in a borrower's standard of living beyond the limits of his own present income. Debt is also a necessary accompaniment of investment. If the borrower is able to use the borrowed funds productively, increasing indebtedness merely represents the shunting of resources not currently needed for consumption into the production of business and individual capital equipment.

Ordinarily, growth in the total debt, public or private, should be closely geared to the volume of accumulating savings. In addition, the quality of the debt is highly important—such things as the soundness of a borrower's affairs, the purpose for which he has borrowed and the terms of the debt contract. Still another factor to be considered is the impact of changing business conditions.

There are those who contend that the growth of private debt has become a threat to the stability and vitality of the economy. I do not believe that this is so. If we include corporate and other business debt and residential mortgage debt as well as consumer credit, the increase in total private debt in the last 2 or 3 years has been little if any faster than the growth in national income. Furthermore, the ratio of private debt to national income at the end of 1957 was not as high as in 1940 or during the 1920's. A substantial part of the debt increase has been associated with the purchase of homes and with the increased sales of consumer durable goods, particularly automobiles. In neither instance does the assumption of debt involve entirely new obligations since for some buyers there is a substitution of mortgage payments for rent and of car installments for public transportation costs.

Looking specifically at installment credit, the burden of repayment still appears to be well within the capacity of the average American family. By and large, sellers and purchasers have exercised good judgment and have succeeded in maintaining installment credit on a sound basis. The concern expressed by some a year or two ago was not justified.

Growth in debt does tend at times to amplify fluctuations in business because debt does not always grow at a constant rate. Sometimes the variations in debt and in income complement each other, but sometimes they do not. Even so, borrowing and lending are still necessary conduits through which the largest part of the country's savings finds productive employment.

THE EFFECT OF GOVERNMENT SPENDING AND TAXATION ON THE ECONOMY

There is no question but that spending by Government and the taxation necessary to support such spending are increasingly important factors affecting economic trends. While this is true of spending and taxation by all levels of government, I propose to limit my comments to the Federal Government.

The persistent expansion of the area and magnitude of Federal spending for nondefense purposes requires, even under present conditions, constant scrutiny by Congress of the individual items of the

budget. The desirability of each item should be judged by its contribution to the national welfare in relation to its cost in taxes. It is still true that Federal spending should not take the place of private spending or of State and local government spending.

Acceleration of expenditures for essential Government projects is, as I have indicated, desirable at this time. However, it is still necessary to spend wisely. Each new proposal should be considered on its own merits.

Turning to the matter of taxation, we all recognize that our present tax structure is the product of topsylike growth. Federal individual and corporate income taxes and Federal excise taxes have been subject to successive rounds of modifications and rate increases to meet emergency conditions. The result is a structure which often distributes the cost of Government among individuals and corporations on a haphazard basis. More importantly, it severely limits the incentive to take risks which it is essential to take if our economy is to continue to grow.

Steps have been taken over the past 5 years to reduce some of the inequities in the Federal Government's tax structure. Permitting a more realistic depreciation of capital equipment for tax purposes is a case in point. The first steps have also been taken toward removing the inequitable double taxation of dividend income.

Beyond this, there is need for a thorough review of the entire structure of Federal taxes. However, the fact that such a need exists should not, in my opinion, divert our attention from the present urgent necessity of an across-the-board reduction in tax rates.

The above represents my best thinking on the topics you asked me to discuss. I trust it will prove helpful.

May I wish you all success in your study. It is the hope of all of us, I am sure, that out of it will come recommendations which will help substantially to maintain a strong and sound economy that will undergird our continued progress as a free nation.

Yours sincerely,

H. H. CURTICE.

METROPOLITAN LIFE INSURANCE CO.,
New York, N. Y., May 5, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: As requested, I enclose my reply to the questionnaire sent with your letter of February 17.

I trust there is no objection to my setting forth in this covering letter a few general thoughts on the problems raised, in the light of which are framed the answers to your committee's questions.

During the 18 years preceding the summer of 1957, we experienced an extraordinary period of expansion. Most of this period could be characterized as a boom. This boom was brought about by a combination of factors dating back to the earlier depression period of the 1930's. The pent-up demand which accumulated during that early period was substantially augmented during the war years that followed.

During and subsequent to the war, we made greater technological advances than in any previous period in our history.

This period was also one of substantial inflation. Historically, wars have always brought about inflation; as illustrative, I attach a chart on prices originally prepared by the United States Department of Labor and brought up to date by subsequent figures from the same source.

Underneath these extraordinary forces was the continuous, natural, long-term growth of our economy.

During this period, in general, demand exceeded supply both of material and labor. It was only natural that labor would attempt to make as many gains as possible. The increase in real wages amply demonstrates its success. It was natural also that increased costs, including labor costs, would be passed along to the consumer, in the form of increased prices, just as long as he was willing to pay them.

The current recession is the natural readjustment from such an extended boom. It is fortunate the boom was not pushed further as, in such a case, the drop would have been greater and the period of adjustment longer.

The question is, What can be done to bring demand back to meet the supply on a sound basis without starting another round of inflation?

One may be sure that, in a profit-motive economy, all segments of business, faced with the present situation, are attempting to put their own houses in order. However, the committee's questions seem to point more to what actions Government can and should attempt.

In considering this, it seems to me that it would be helpful to have clearly in mind the relative parts that each contributes to the whole. The United States Government is playing a larger role in the economy today than even before, except in time of war. The Federal Government's expenditures in 1957 amounted to almost $80 billion, and yet

25420—58—pt. 2——4

this is only 19 percent of the gross national product of 434 billions. Nevertheless, Government operations are so great and have such a psychological impact that what Government does is of tremendous importance.

However, it would seem that the real key to improving the situation rests in the actions of those responsible for the remaining 81 percent of the gross national product. This line of reasoning is not intended by any means to say that Government has no role to play. It can and does play an extremely important role in ironing out the peaks and valleys. The dangers lie, however, in the fact that in a natural desire to do something to assist in the situation, Government can take action inimical to business. In order to bring about immediate temporary gains, Government can unintentionally prolong the recession; it can take actions which, in the long run, may make even more difficult our essential objective of overcoming future inflationary tendencies.

The worst depression our country has ever had was the one from 1930 to 1939. During that period, we ran a Government deficit in every fiscal year but one, totaling nearly $24 billion. Our total unemployment ranged from 9 percent to 25 percent of the labor force, and in 1938 and 1939, the end of the period, it was still running at 19 percent and 17 percent respectively. Today it is said to be 7.7 percent. In the circumstances, I am not convinced that deficit financing is the way to bring the country out of a recession.

Of course, no one wishes to see people without jobs if they are willing and able to work. In today's society we must see to it that at least a reasonable minimum standard of living is provided by American business, or, if necessary, through Government aid, to take care of those who are out of work and unable to take care of themselves. But the worst thing that could happen to this country would be a continuation of the inflation we have been experiencing since World War II. It would be far, far worse than a few months of modest recession and the limited, temporary unemployment that is currently taking place. History has amply demonstrated that in periods of drastic inflation everyone, with the possible exception of a few international speculators, suffers tremendously, but those who suffer the most are the working people.

In combating the present recession, I believe the Government can play its greatest role in encouraging a sound monetary policy and, if necessary, assisting in the extension of unemployment insurance. It can also speed up the timing on those projects which naturally fall within the governmental sphere and which must be done sooner or later anyway. It can also cut unessential Government spending and conduct its operations as efficiently as possible, thus keeping its finances on as sound a basis as possible.

Our country is basically sound today. There is a very substantial backlog of savings. Generally speaking, individuals are not too overextended with debt. The way out would seem to be harder and more efficient work by all of us, which plays its role in lowering costs. In general, capital automatically takes a lower return in recession periods. Lower prices are an incentive to increased purchases. These natural results should not be interfered with. They are a great help in correcting situations such as the present. Steps which lead to rigidity of costs are undesirable. We might also remember that some

of our most prosperous periods have been accompanied by gradually falling prices.

In conclusion, I would stress the importance of viewing the situation in balanced perspective. The bulk of the unemployment is concentrated in the durable goods industries, such as steel and automobiles, which is the usual pattern in periods of recession. While we all have a natural and proper desire to lessen the difficulties of the unemployed, can this not best be accomplished by concentrated efforts rather than by broad scale expenditures of Government funds with all the subsequent difficulties entailed? After all, we do have, by latest figures, approximately 63 million, or 92 percent, of the labor force at work.

Sincerely yours,

F. W. ECKER, *President.*

REPLY BY FREDERIC W. ECKER, PRESIDENT, METROPOLITAN LIFE INSURANCE CO., TO QUESTIONNAIRE OF SENATE FINANCE COMMITTEE

1. Give a definition in your own words of deflation and inflation.

Inflation is that type of unbalanced economic situation which is eventually reflected in a major decline in the value of money. Deflation is the reverse.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

If we can avoid inflation, we shall have taken a long step toward avoiding not only deflation but recession and depression as well. Economic collapse inevitably follows inflation eventually. As a consequence, we should be constantly aware of the dangers of inflation and attempt to avoid or to slow down in boom periods those activities which are of an inflationary nature.

In periods of recession, such as the present, there are particular dangers in attempting to correct too quickly a temporary decline by taking hasty and improvised steps which, in the long run, lead to much greater and more serious troubles and sow the seeds for future inflation, creeping or otherwise. The Honorable William McC. Martin expressed the desirability of avoiding creeping inflation far better than I could when, in discussing this subject before your committee on August 13, 1957, he said:

"No greater tragedy, short of war, could befall the free world than to have our country surrender to the easy delusion that a little inflation, year after year, is either inevitable or tolerable.

"For that way lies ultimate economic chaos and incalculable human suffering that would undermine faith in the institutions of freemen."

If a certain level of prices can only be maintained by added doses of inflation, it is far better to let those prices fall and reach their natural level than to continue the antidote.

With regard to the legislative portion of the question:

(*a*) It would seem desirable to write explicitly into the Employment Act of 1946 what is said to be there implicitly, viz., that the administering Government agencies have a responsibility not only to attempt to maintain high employment but also to avoid inflation.

(*b*) Another policy of utmost importance is to keep the Federal Reserve System from again becoming subservient to Treasury dictation. Of course, it should cooperate, but Treasury policies should not be forced upon it. The long period of pegged interest rates before World War II was a strong inflationary force until the March 1951 accord. Senator Paul Douglas, a member of this committee, gave an excellent exposition on this subject on the floor of the Senate in 1951 (Cong. Rec., Senate, Feb. 22, 1951, p. 1521).

The accord of March 1951 is working well today. I am not sure that any further legislation is required on this point in order to assure the continuance of the accord. However, a declaratory resolution amounting to a reaffirmation of Federal Reserve Board autonomy might well serve to ward off any future attempt to make the Board again subservient to the Treasury Department.

(*c*) The economics in the executive branch of the Government advocated by the several proposals of the two Hoover Commissions should be advanced.

(*d*) The enactment of the bill sponsored by Senator McClellan and 70 other Senators, providing for a joint committee on the budget with its own staff, would seem most appropriate. Although passed by the Senate last year, it awaits House action.

(*e*) The President should have the power of item veto in appropriation bills. This power is available to the governors of some 40 States. With government taxation as heavy as it is these days, surely the closest control is warranted.

(*f*) Consolidation of appropriation bills and other suggestions for tightening up the appropriation and expenditure processes would seem to have much merit also.

(*g*) Some provision for reduction of the national debt should be included in all Federal budgets. In recent years of high prosperity, there has been a conspicuous failure to reduce the national debt. It is recognized, of course, that in certain periods of recession, this may not be possible. Obviously, there are times when the Government might have to operate with a deficit, but certainly in good times we should reduce the debt by some amount, even if it is only 1 percent per year.

(*h*) It is not wise to avoid debt limitation by excluding capital expenditures from the budget (such as for post offices, etc.). We shall have to pay out more in taxes in the long run by leasing such properties than by including the capital expenditures in the budget.

(*i*) It is suggested that unwarranted increases in social security benefits add to inflationary forces. In this and other connections, attention is invited to the statement of February 1958 of the life-insurance business on this subject entitled "Sound Policy for Social Security." (Retained in committee files.)

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942 to 1957. (You may wish to divide the period into two parts, 1942–50 prior to the accord, and 1951–57.)

For a number of years before the accord of March 1951, monetary policy was directed primarily toward pegging the market interest rates on Government securities at low levels. The effects of that policy carried through the entire financial structure—private as well as governmental.

Whatever may have been the need for such rigid support of Treasury securities throughout World War II, and the question is moot, maintenance of an inflexible interest-rate policy thereafter was harmful because of its inflationary effect.

The pegging of interest rates at low levels virtually sidetracked other objectives of monetary policy. It resulted in tremendous acquisition of Treasury securities by the Federal Reserve. An overall effect was to provide huge additions to reserves of commercial banks, thus inducing them to expand credit to their customers readily—even though certain credit-restraining actions were taken at times.

The inflationary influences of that policy, together with the inflationary results from heavy Government deficit financing through banks before and during the war, have been prevalent through the economic system for a long time afterward and probably have played a part in bringing about the postwar inflation from which our country has been suffering. In fact, their potentialities probably have not been entirely dissipated even yet. Actually, the low costs of Treasury financing proved to be high costs to the Government and to the economy as a whole, in the light of the ensuing inflation.

The freeing of interest rates permitted by the accord in 1951 contributed in an important way to greater economic stability. Since that date, monetary policy has been appropriately operative. While occasionally one might have some differences of opinion on timing, the overall objectives and operations have, I believe, been splendid and have met with considerable success.

While monetary policy by itself cannot be expected to do the whole job of keeping our economy in balance, it can help considerably in creating a healthy climate for economic life.

4. Beginning in August 1956 there was an increase in the consumer price index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar?

Inflationary trends had been so solidly set in this country that the indications of a slowing up in business have not yet had very much effect on the consumer price index. These trends, which have continued into 1958, are due to such factors as these:

(1) It took longer than expected in our free and expanding economy to fill the demands brought about by war shortages—so much longer that many, in appraising the demand, assumed without warrant that it was due to the natural expanding economy rather than to the fulfilling of pent-up, wartime demands. It also took a longer time than expected for portions of the economy to be infected with the inflated prices already evident elsewhere.

(2) Inflation which had been forced into our economy during the depression and war years was still exerting an effect and continued to contribute to the fall in the value of the dollar.

(3) War controls on rent had been removed very slowly so that their adjustment to the rest of the economy was still playing an important part in the upward trend of the consumer price index.

(4) Price supports in the farm area, drought in certain cattle-producing areas, and freezes in the citrus-growing areas all played a part in the continued uptrend of prices.

(5) Personal incomes continued to rise even after output started to ease off more than a year ago. Built-in wage escalation in certain union contracts contributed in part to this rise in income.

(6) The fact that increased costs could be reflected in increased prices, and goods still sold, undoubtedly played a part in adding the increased cost to the sales price as long as it could be passed along to the consumer. The final test, of course, is the consumer's willingness to pay.

(7) Some economists had written profusely on the inevitability of continued inflation and too many businessmen believed them and made their plans and took concrete steps accordingly. When trends continue in one direction for a substantial period of time, it is human nature to feel that the trend will continue indefinitely.

(8) Increases in wages have not been offset by corresponding increases in productivity.

(9) Until 1956, the retail prices of some goods had been declining for a few years. This was partly attributable to productivity gains. This helped to offest the rising changes for services and thus the Consumer Price Index was kept fairly stable between 1952 and 1956. However, by 1956, the rise in wage costs had begun to exceed productivity gains. This, plus the tremendous demands of 1956 and the boom psychology, forced the retain prices of goods upward. This upturn, on top of the rising charges for services, forced the Consumer Price Index to new highs.

5. What effect does the management of the current public debt have upon the national credit structure and the economy of the United States?

Through the types of securities offered, and the terms and timing of the offerings, debt management can have a great variety of effects. It can starve or deluge certain parts of the investment market; it can diversely affect commercial bank reserves, the money supply, the liquidity positions of individuals, and businesses, the interest rate structure, saving, etc.

One important aspect is the interference that debt management gives, at times, to free operation of Federal Reserve policy, even though Government securities are no longer so fully supported as before the accord of March 1951. It is well recognized that Federal Reserve policy actions are limited in some degree when consideration must be given to impact on Treasury debt operations.

Frequent refunding operations also often disturb and interfere with corporate and State and local government security financing. Better spacing, with a larger part of the debt in longer maturities, will help relieve that situation.

One other disadvantage in having so large a portion of debt in short-term (bank medium) type securities is that our economy is subject to rapid changes in interest rates, and in periods of tight money the service charges can rise very rapidly when so large a portion of the debt is involved.

It is the announced intention of Treasury Secretary Anderson to continue to work toward the goal of having a larger portion of our debt in longer term maturities.

Refunding also can shift ownership of Treasury securities among Federal Reserve banks, commercial banks, and other—with great differences in effects.

Without attempting to describe the mechanics by which these effects occur, I would emphasize the importance and variation thereof.

Nevertheless, debt management policy should not be a primary tool of monetary policy. The main objective of debt management should be to improve the fiscal position of the Government. If, meanwhile, it can aid Federal Reserve policy without neglecting its fiscal policy objective, so much the better.

6. (*a*) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

1. Price stability.
2. Stability of production, demand and employment.
3. Economic growth in production, demand, and employment.

(*b*) With respect to these 3 objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II—during the most recent 2 or 3 years—especially during 1957.

(*a*) Our desire is for an economic growth as constant as possible, supported by demand, which will provide the maximum practicable employment. However, this can be best be achieved with price stability and without inflation. Even then, in a free economy, we are bound to have periods when demand exceeds supply and vice versa. Price fluctuation is one of the means by which balance in these areas is restored.

If we rely on inflation to provide a continuous increase in demand and constant full employment, we are not only doing a great disservice to large segments of our population now (the aged, those on fixed incomes, and those dependent upon them, of whom there are many more than in the ranks of the temporarily unemployed), but our economy will ultimately be thrown out of balance to such an extent that a disastrous relapse will eventually occur.

(*b*) Since World War II, and especially during the 2 or 3 years culminating in 1957, our growth has exceeded the rate sustainable for a protracted period. What has been interpreted as "growth" is really, to a considerable degree, a strong cyclical boom which inevitably brings an aftermath of recession such as we are now experiencing. Sound economic growth is bound to reappear. However, price stability will be sacrificed in the future if we do not at least tolerate, and even encourage, some price decline now. Short-run flexibility in prices is essential to the maintenance of reasonable price stability and stability of employment in the long run.

7. Give your opinion of the effect on our economy of current Federal, State, and local government spending.

Of course, there are areas of expenditures which can only be at the Federal level—defense, etc. However, to the extent possible, I believe Government spending should be at the State and local levels since, being closer to the grassroots, it provides for better control by those who pay the bill. I recognize, of course, the need for pacesetting, and that the ability to pay is different in some sections of our country than in others. Nevertheless, these arguments can and at times have been overdone. Federal Government spending is now at too high a level for the long-run stability of our economy.

High taxation is inimical to the development of free enterprise, which has built this country. It deprives the individual of just

rewards for his labor and thus inhibits initiative and in time reduces all to a level of mediocrity. Because of the advantages available to those who evade taxes, it also, unfortunately, gnaws away at morals. It is a common attribute of human nature to say: "Well, if he can get away with it, why shouldn't I?"

It is recognized that, under present circumstances, support of government through heavy taxation is essential. However, since the burden is such a heavy one, there is all the more reason that every item should be scrutinized with the objective of cutting out every unessential expenditure program, and essential should have a pretty restrictive meaning.

High government spending results in high taxes and too frequently in the growth of government debt. It encourages inflation. We cannot neglect spending if it is genuinely essential for national survival. However, rather than directed by government, manpower and capacity may well be better utilized in producing the goods and services which people can freely afford to buy.

As soon as possible our entire Federal tax system should be reviewed. Much has been incorporated on the basis of war necessities which is detrimental to the best development of our American way of life.

8. Give you opinion of the effect on our economy of current Federal, State, and local taxation.

The real core of the tax problem is that taxes are too high in general—too high for long-run economic stability and orderly economic growth. Right at present we must endure the situation, but we should be able to look forward to the time when a reduction of taxes along with a balanced budget can be achieved.

High taxes cut into amounts that might otherwise be saved by individuals and businesses to finance a larger share of capital outlays than is the case at present. They also discourage the accumulation and investment of venture capital. Business decisions are too much influenced by tax aspects alone. High taxes foster tax evasion and tax dodging.

There is something fundamentally wrong with a tax structure that penalizes hard work, risk taking, and achievement.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes, and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

I agree with the testimony given by Federal Reserve Board Chairman Martin, who is far better qualified to speak on this subject than am I.

I refer to his statement before your own committee August 13, 1957, at pages 1229–1234 in part 3 of your Investigation of the Financial Condition of the United States.

It seems to me that monetary and credit policy should be relied upon principally to help regulate inflationary and deflationary pressures. The first objective of fiscal policy should be to operate Government affairs on a fiscally sound basis. It is difficult for me to conceive of emergencies where that primary objective should be subordinated in an attempt to regulate the condition of the whole economy. Such

use of fiscal policy is more apt to be a palliative rather than attacking the fundamental causes of any maladjustment.

10. (*a*) Comment generally on the adequacy or inadequacy of the United States monetary system. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits.) Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

(*b*) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

(*a*) The monetary system of the United States appear to me to be operating well. Consequently, I have no suggestions to make with respect to it.

(*b*) I would make the following comments with regard to our fiscal system:

(1) It would seem desirable to further the studies which I understand are now being made with regard to the better apportioning of sources of revenue between the Federal, State, and local governments.

(2) At the present time approximately four-fifths of the Federal Government's revenue is derived from personal and corporate income taxes. It would seem desirable, if possible, to utilize some other form of taxation rather than to rely on the income-tax approach for so large a proportion of the whole.

(3) As mentioned elsewhere, it would be most desirable to see to it that in prosperous years our Federal debt be reduced.

11. (*a*) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy?

(*b*) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full employment goals?

(*a*) While there may be a paradox in the short run, in the long run, rising prices can be expected eventually to price the product out of the market. Then the reduced demand brings about unemployment. Escalator clauses and other factors, such as drought and frost, are still playing a temporary role in the current situation.

(*b*) I cannot overemphasize my belief that a gradual inflationary trend is not desirable, nor is such inflation necessary to achieve and to maintain what normally should be considered full employment.

Gradual or "creeping" inflation is bound to bring about an inflation psychology which eventually will develop into rampant inflation and ultimate collapse. Commonsense, and the lessons of history, are unanimous in leading to this opinion. Once inflation psychology gets started, Americans would be quick to grasp the idea that it may well continue. What are reasonably intelligent men to do? Most would turn their ready cash into tangible goods, with the expectation that the value of the goods would increase, and the value of cash in the bank decrease.

Another obvious step to hedge against inflation would be to borrow as much as possible in order to buy goods—again with confidence that the goods could be sold for more than they cost, and that the loans could be paid off with correspondingly less goods than were bought with the proceeds. That is the A B C of inflation, but what does it do to the economy? It is not necessary to spell that out. It is obvious that in the end the one who suffers the most is the workingman. He

does not have the reserves, nor the credit to borrow, in order to buy the goods. Furthermore, under such circumstances, the Government would not be strong enough financially to come to his aid. That is the history of inflation all over the world. We cannot afford to ignore these universal lessons.

We are most fortunate, in view of the inflation we have experienced, that an inflation psychology has not as yet permeated the country. Should that ever come about, the result would be disastrous. The time to stop a forest fire is before it gets started. That is why it is so essential that, in the current minor recession, we do not kindle inflationary flames which may be impossible to extinguish in the future.

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy.

I doubt whether the growth of private debt has become a threat to the stability and vitality of the American economy.

Corporate debt does not seem to me to be excessive.

I suspect that we may have gone too far in lowering or eliminating downpayments, in increasing the terms of Government insured or guaranteed mortgage loans on homes. Only after a longer testing period shall we really know the answer. I think it sound to take these actions in periods of depresison or recession. However, in the boom periods of prosperity, credit should be tightened up. Otherwise, we merely inflate costs. I recall very little evidence of tightening in boom periods.

While consumer debt does not seem to have gotten seriously out of hand, its expansion may well have played a part in the present recession. It is natural, under present circumstances, that each individual reappraise his own situation. In a period when some have lost their jobs and many are no longer receiving overtime pay, we all very understandably become more cautious. Those with jobs may well and properly feel that before committing themselves to further time payments, they would like to get their present obligations paid off. This would seem to be a pretty sound objective both for the individual and for the future of business as well.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy.

The answer to this question is so dependent on public psychology that I do not believe an answer can be given based on mathematical indices.

In the first place, with our present system of reporting, all such indices are quite late. Trends may well have changed before we receive definite figures. We just have to use our best judgment in the light of the figures we have and a feel of the situation.

While I would not rule out entirely a tax cut if the situation became bad enough (which I do not anticipate), I am less than enthusiastic regarding its advantages in the present situation. To cut taxes when expenditures are such that we would still have a balanced budget is one thing. However, with present tax rates it would appear that we are facing a budget deficit in fiscal 1959, and to increase that deficit in

the hope that it would play a significant part in stopping the recession is quite problematical. The one thing we know is that it would increase the Federal debt just that much more. We must pay that debt ultimately or pass it along to our children. I do not think that things are so bad today that we should shift that burden to others.

I would certainly agree that basically taxes are too high and that they should be cut as soon as it can be done on a sound economic basis. Such a tax cut should include a reform of the basic tax structure. One such plan is set forth in the Sadlak-Herlong bills, which would gradually reduce all bracket rates over a period of time without narrowing the tax base.

I do not think that public works should be undertaken just for the sake of spending money. If they are necessary, and would be done sooner or later anyway, it would be well to undertake them now.

When people are out of work, all of us, of course, have a great desire to do something to help them. However, if possible, we ought to be certain that we do something which will largely accomplish the result intended and not something which stores up more difficulties for the future. I find it difficult to overlook the history of the 1930's.

14. How much of a factor in your opinion has deficit spending by the Federal Government since the end of World War II been in contributing to, or producing inflation?

Directly, deficit spending by the Federal Government has not been a major factor among the forces contributing to monetary expansion during the period since World War II. For the most part, deficits were not financed by expansion of commercial or Federal Reserve bank credit. They were financed largely by nonfinancial corporations and individuals.

Monetary expansion within the period was very largely the result of borrowing by individuals and business. Indirectly, Government deficits did contribute to inflationary pressures. Financing of Government deficits by individuals and businesses absorbed funds which might otherwise have gone to finance a portion of the requirements of private enterprise which were financed by commercial banks.

15. Can full employment goals be attained while maintaining a dollar that has relatively stable purchasing power?

The answer to this question is "Yes"—if "full" be defined, not literally as a perpetual 100 percent, but as reasonably perpetual and reasonably near 100 percent. However, overfull employment, which we have had, cannot be maintained together with a dollar which has stable purchasing power. Overfull employment leads to lack of individual productivity.

A certain amount of labor turnover, and other temporary "frictional" idleness—or "labor float," as it is sometimes called—is bound to be present in a free-exchange economy.

It seems to me that high employment can be attained and sustained only if we also have as a major objective the relatively stable purchasing power of the dollar.

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

I doubt that escalator provisions are compatible with economic stability. I am strongly in favor of wage earners having opportunities to increase their income. However, it seems to me that increased

income should come about because of increased responsibility or increased productivity.

Escalator clauses appear to be designed to compensate for past increases in prices or productivity, but they are also vehicles for prolonging into the future past inflationary pressures, thus perpetuating a vicious circle. There develop situations wherein demand-supply conditions call for a price reduction in a particular product. Yet a wage escalator in the industry concerned helps prevent such concessions to the consumer and the employment gain which could have resulted. The fact that such automatic raises set a pattern which nonescalated enterprises feel they must follow puts even more of the economy in a position where it not only hesitates to cut prices but may even be forced to lift prices.

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.

The causes of the present recession are the result of a natural reaction to the almost continuous inflationary boom we have been experiencing since the termination of World War II.

During the depression prior to World War II, and during the war period, there accumulated a very sizable demand for a great variety of goods. This was further augmented by a substantial increase in family formation subsequent to the war. The demand ranged all the way from housing to all kinds of consumer goods. In a free enterprise system, business should and must expand to meet the demand. Before the demand was met the Korean war engendered another war economy and extended still further the time at which supply and demand could be brought into balance. As in all such periods following wars, inflationary forces were very strong.

Under such circumstances, it was natural that strongly unionized labor should take the oportunity to increase wages—the higher levels were reflected in nonunionized areas as well. In view of the strong consumer demand then in evidence, industry did not hesitate to pass along such increased costs to the consumer by way of increased prices.

This sequence might be reversed and the claim might be made that the increase in price level caused the increased demand for higher wages on the part of labor. This may be true. However, irrespective of which came first, we were definitely in an inflationary spiral. This spiral continued for so long that many felt justified in assuming that we were in a new era of continually rising costs, prices, and demand.

The backlog of war-induced demand was finally satisfied and increased production in some areas outran the normal demand at the price levels then current. Production naturally had to be cut back; some unemployment followed. In a situation such as this, it is natural for people to become more cautious. Considering the height to which we went, consumer purchasing has held up amazingly well. That is because the economy is fundamentally sound; people have a good backlog of savings and unemployment insurance is playing its allotted role.

We are striving now to secure again a balance between demand and supply. This does not happen overnight. It would seem that this balance must be achieved at a lower level than heretofore. I trust it will be achieved on a basis from which we may build soundly and thus reach higher levels of production and standards of living than ever before. It would be the greatest mistake to attempt to achieve this

balance through inflationary means. Inevitably this would lead eventually to a drastic collapse.

Now, just what can and should be done to get us moving ahead again on a sound basis? Unfortunately, there is no easy solution. It will come about through a combination of factors. Business and the consumer are far larger factors than is Government. Business can expand its market through lowering prices. Where this has been tried, it has achieved results.

This may well mean that profits will have to be reduced until the economy starts forward again. In the meantime, at least overhead should be covered. It may mean that there will have to be some wage and salary cuts. Certainly it means that everyone should work a little harder, produce a little more for the wages they receive, but if prices come down, no real hardship will ensue.

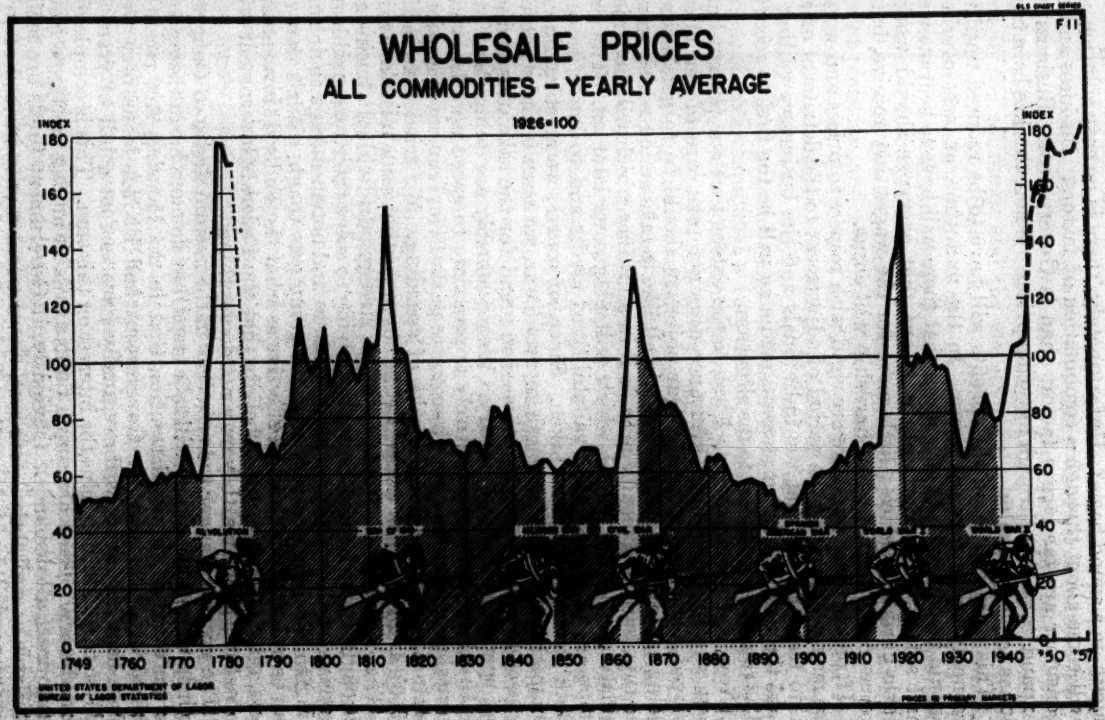
If, on the other hand, we are rigid with respect to prices and wages, we may well prolong the period of adjustment to the detriment of all. I do feel strongly that the individuals and the businesses willing to take the temporarily unpleasant medicine will be the first to recover. The consumer is the key to the situation.

Now, as to Government: First, to the extent that our present business and unemployment insurance does not take care of the unemployed, Government must. Our objective should be to get business going again. Of course, we would all like to take action which would do this, but the difficulty is to do it in a manner which will not inject inflation in our economy which will plague us later on. The first steps are to expand the availability of credit and to lower its cost. Both have already been taken. Since, of course, we must retain our competitive military strength to avoid war, we must spend whatever is necessary to accomplish this—not spend for the sake of spending, but spending what is necessary. We presumably are doing this.

Third, it would seem entirely appropriate to speed up all governmental programs which are a requisite part of Government operations, but not just spend for the sake of spending. We tried that in the 1930's and it did not work. Let us not make that same mistake again.

The country is fundamentally strong. Individual businesses throughout the United States are trying to solve their own problems. Let us give them an opportunity to do so and not encourage their running to Washington every time the going gets tough. What they do can be at least four times as effective as what the Federal Government does, and if they are led to believe that the Federal Government will solve their problems, they may not do anything.

The greatest danger today is that in the natural desire of Congress to help the situation they will take steps that do more harm than good. As an example, I would mention that in the Housing Act recently passed, the provision for Government and FNMA loans may well mean that taxpayers will eventually have to foot a bill of from $1 billion to $1.5 billion, plus the interest on this sum. This is completely unnecessary. There are ample funds available among mortgage lenders to meet all demands. Obviously, if Government funds are made available at a slightly lower cost, Government money instead of private money will be used, but the taxpayer instead of private enterprise will foot the bill and, more important still, private enterprise may well reduce its facilities for making such funds available—which may have a more lasting effect than the $1 billion involved.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CIVIL WAR
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

THE NORTHWESTERN MUTUAL
LIFE INSURANCE CO.,
Milwaukee, Wis., April 15, 1958.

Hon. HARRY F. BYRD,
United States Senate,
Committe on Finance,
Washington, D. C.

DEAR SENATOR BYRD: Supplementing my letter of April 7, I am happy to enclose an original and two carbon copies of the completed questionnaire of the Senate Finance Committee.

I greatly appreciate your invitation to participate in this study and believe that it can be constructive.

Sincerely yours,

EDMUND FITZGERALD, *President.*

REPLY BY EDMUND FITZGERALD, PRESIDENT, NORTHWESTERN MUTUAL LIFE INSURANCE CO., TO QUESTIONNAIRE OF SENATE FINANCE COMMITTEE

1. Give a definition in your own words of deflation and inflation.

Inflation is a rise in the general level of prices; deflation is a fall in the general price level.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

Federal monetary and fiscal policies, if wisely and courageously administered, can bring to bear the forces necessary to achieve reasonable price stability. It is important that the Federal Reserve, the Treasury, Federal lending agencies, and Congress coordinate their policies toward the common goal of price stability.

The responsibilities of the Federal Government to help to maintain a stable price level should be further clarified. The Federal Employment Act of 1946 should be amended to include this responsibility as a specific objective of public policy.

Since prices are affected by costs, and wages are a major factor in determining costs, the inflationary effect of the power of labor to secure wage increases in excess of increases in productivity should be given careful congressional consideration. Further, wage rate rigidity tends to limit flexibility of prices which can be helpful in limiting economic swings.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942 to 1957. (You may wish to divide the period into two parts, 1942–50 prior to the accord, and 1951–57.)

The policy of pegging the price of Government bonds and thus increasing the money supply by keeping interest rates at an abnormally

low level was not a satisfactory program. While requirements of national security may have made it excusable during wartime, it constituted an inflationary course in the immediate postwar era.

Monetary policy, since the accord, has been generally constructive. It is only with the wisdom of hindsight that we can say that on balance a more prompt and vigorous policy of credit restraint on the part of the Federal Reserve might have had a moderating effect on the excessive credit expansion that brought on the 1955 boom.

4. Beginning in August 1956, there was an increase in the Consumer Price Index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar?

Concurrent increases in the demand for goods and services on the part of consumers, business, and Government were greater than the national product available. An overexpansion of credit in 1955 and wage increases in excess of increases in productivity had led to increased consumer spending power. The easy credit had also put pressure on the economy by facilitating new highs in business spending for plant and equipment. Finally, increased expenditures at all levels of Government competed for the supply of goods and services available.

5. What effect does the management of the current public debt have upon the national credit structure and the economy of the United States?

The effect of frequent Treasury borrowing when the economy is operating at high levels is to force the Federal Reserve to pursue a less restrictive monetary policy than might otherwise be followed. Greater price stability could probably be achieved if the Treasury took steps to rely more on long-term issues thereby having less impact on the Federal Reserve monetary policy.

In managing the Federal debt, it is desirable that the obligation should be placed, as far as possible, in the hands of investors other than banks. Selling Treasury securities to banks when national resources are fully employed can only result in an inflationary increase in the supply of money.

6. (*a*) Discuss in their relationship to one another and according to your judgment of their relative importance, the following 3 objectives of economic policy in the United States:

1. Price stability.
2. Stability of production, demand, and employment.
3. Economic growth in production, demand and employment.

(*b*) With respect to these three objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II—during the most recent 2 or 3 years—and especially during 1957.

(*a*) The objective of price stability should be on a par with the objective of full employment and a growth of productivity which will maintain and increase our standard of living.

(*b*) The continued failure of our economic measures to achieve reasonable price stability is the most significant and challenging trend of the last decade.

7. Give your opinion of the effect on our economy of current Federal, State, and local government spending.

While it would be desirable if State and local spending could be curtailed to ease the local tax burdens, it is questionable whether this would have an appreciable effect on the national economy. On the other hand, some restraints in Federal spending might have built up a Treasury surplus which would have had an anti-inflationary effect. Instead, the Federal Government continued to spend as much as, and more than, tax receipts and thus added to inflationary pressures. The Federal Government should take advantage of times of high prosperity to reduce or eliminate operations of questionable long-term economic soundness as farm price supports and certain veterans support programs. National defense expenditures are vital, but in periods of prosperity it is unsound to permit deficit financing if it is to be eventually paid for by the most inequitable of all taxes—the inflation tax.

8. Give your opinion of the effect on our economy of current Federal, State, and local taxation.

The antiquated nature of State and local taxation in the face of necessary expenditures at these levels of government has resulted in increased demands for Federal subsidy for State-local programs. State and local tax revision is sorely needed to preserve the efficiency of balancing taxation and expenditure at each level of government. The Federal tax structure also needs changes to remove inequities, to provide the incentives essential for economic growth and to encourage increased national savings which under conditions of full employment are the only noninflationary source of funds for new capital formation. However, tax reform must start with reduced expenditures.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes, and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

Monetary policy relates to the management of the Nation's supply of money as carried out by the Federal Reserve System. Fiscal policy relates to Federal taxation, expenditure, and debt management.

The Federal Reserve's monetary policy may be used to restrain inflation by forcing an effective contraction of bank credit and the money supply through open market operations, increases in the discount rate, and increases in bank reserve requirements.

Fiscal policies are generally too inflexible to provide quick counters to inflationary or deflationary tendencies in the economy. For the long run, tax rates should be set to balance expenditures and provide some margin for debt retirement in times of high employment. While the pursuit of positive counterinflationary debt management policies would be difficult, effort could be directed to the reduction of short maturity issues since such activity is at cross purposes with Federal Reserve monetary restraints.

10. (*a*) Comment generally on the adequacy or inadequacy of the United States monetary system. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits.) Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

(*b*) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

(*a*) The monetary system of the United States as managed by an independent Federal Reserve System is fully adequate. It would be desirable if the activities of other Federal lending agencies were coordinated with the Federal Reserve so that all Government agencies would act consistently with monetary and other stabilization policies. However, under no circumstances should the independence of the Federal Reserve be impaired.

(*b*) While the fiscal system of the United States is adequate to provide for economic growth while maintaining price stability, it would be helpful if the President could veto individual items of an appropriation bill. The adoption of performance budgeting would be an important step in strengthening the fiscal system.

11. (*a*) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy?

(*b*) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necesary) to achieve and maintain full employment goals?

(*a*) There is no ready answer to this question. It may be that there is a lag relationship between increasing unemployment and resultant lower prices which is yet to be realized. It may be that for a time there can be rising labor costs in the face of falling demand because of increased union demands. It is not likely that the condition can exist over a long period of time.

(*b*) A gradual inflationary trend is undesirable and not necessarily a concomitant of full employment. Where it exists, monopoly power of both industry and labor should be curtailed so that wage costs and prices can be kept in line with productivity increases.

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy?

Although the growth in private debt in 1956 and 1957 may have been excessive, continued growth in private debt is inevitable in an expanding economy. The Federal Reserve should, through its general monetary policies, influence the rate of growth of private debt. Cooperation of all the lending and loan agencies of the Federal Government with the Federal Reserve is essential.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy?

It is hard to say at what point the Federal Government should move in major ways to counteract a downturn in the economy. Generally speaking, there should be clear signs that the recession is something more than a moderate adjustment. In this respect, the temporary recessions in 1949 and 1954 can serve as guideposts.

14. How much of a factor in your opinion has deficit spending by the Federal Government since the end of World War II been in contributing to or producing inflation?

On balance, deficit spending by the Federal Government over the past decade has not been carried out on a scale to contribute greatly to inflationary pressures. However, instead of even approaching deficit spending, the Federal Government should have been able to

stabilize Government spending and thus generate surpluses as tax revenues grew with the expanding economy. Instead, increasing Government expenditures in the face of increasing private demand tended to produce inflation.

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

These two goals need not be contradictory. High employment can be had along with reasonable price stability. This is demonstrated by the period 1951 through 1955 when the country experienced both high levels of employment and relative price stability.

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

Escalator provisions in wage and other contracts contribute to the cost-price spiral. Therefore, they are not compatible with achieving economic stability.

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.

The present recession was caused by the interaction of many forces including:

1. Very high business inventories relative to demand.
2. Rapid curtailment of Government spending at a time of decreasing private demand.
3. Rapid increases in plant and equipment and consumer durable expenditures in 1955, 1956 and 1957 accompanied by a large expansion of credit.

To terminate the recession, monetary policies should be eased to promote private spending, and Government spending should be increased to take up some of the slack in private demand. If the situation continues to deteriorate, substantial temporary cuts in personal income taxes and an accelerated program of necessary public works should be initiated to stimulate the economy. Advance planning should provide that remedial tax measures and increased public expenditures can be quickly reversed so that they will not contribute to inflationary pressures when recovery gets underway.

THE CLEVELAND TRUST CO.,
Cleveland, Ohio, March 25, 1958.

Hon. HARRY F. BYRD,
Chairman, United States Senate Committee on Finance,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: I admire you so tremendously and appreciate all the sacrifice, and storm and stress you have gone through, trying to save something in our economy.

Answering your form letter of February 17:

1. The popular definition of "inflation" is a rise in prices and the cost of living. Technically, however, inflation is the pressure which causes prices to advance, rather than the rise itself.

One should distinguish between the so-called "classic" type of inflation and the "creeping" variety. In the past, the former has been due to huge deficit financing by governments, usually during and after major wars. This rapidly swells the money supply and results in too much money chasing too few goods, with the consequent bidding up of prices. In the United States, each great war has generated a great inflation reflected in a violent price rise.

The creeping inflation of the last 2 or 3 years has occurred chiefly because wages (including fringe benefits) have increased faster than productivity, or output per man-hour. This rise in wage costs per unit of production causes management to attempt to offset higher costs through higher prices, in order to keep a margin of profit.

Historically, the conditions producing a big inflation have also produced a business boom, high employment, and speculation. Eventually such booms have collapsed into deflation, poor business, and reduced employment. In such deflationary periods the supply of goods exceeds that of money, bringing liquidation at falling prices as in 1921.

Inflation is not always associated with commodity prices. There was no noticeable advance in commodities in the late 1920s, yet there was a monumental inflation of stock prices followed by the worst deflation ever experienced in the United States.

2. In trying to avoid inflation or deflation, the following methods are helpful.

(*a*) Avoidance of continual heavy deficit financing by the Government. This does not preclude deficits to stimulate the economy in poor times, provided that surpluses are achieved in good times.

(*b*) Aiming monetary policy at preventing the money supply from becoming either too large or too small, relative to the needs of normal economic growth.

(*c*) Avoiding wage increases in excess of advances in output per man-hour.

Concerning laws, labor unions have become big business as well as corporations, and should therefore be brought under the antimonopoly laws. They should also be subject to regulation as to financial statements, and use of dues and welfare funds.

3. From 1942 to 1950 the Federal Reserve System was committed to the purchase of Government bonds at par, and could not exercise adequate credit control.

In my opnion, the System on the whole has done a good job of credit regulation since the accord of March 1951. In 1952 and up to mid-1953, when business was rising, it followed a policy of restraint. This was superseded by credit ease during the 1953–54 recession. Credit restraint was again applied in 1955, 1956, and most of 1957, when the trend of gross national product was upward. Perhaps the System switched to easy credit too soon in 1953, as stated by Federal Reserve officials themselves. The precise timing of such changes is difficult.

Concerning 1955–57, it is true that credit restraint failed to prevent creeping inflation—i. e., wages rising faster than productivity. But if an easy-money policy had existed, inflation would no doubt have been greater and might have brought an old-time speculative boom.

4. The principal factor in the decline in the purchasing power of the dollar in 1956–57 was wage increases in excess of gains in output per man-hour, which caused an upward pressure on prices.

5. During the current business recession, a budget deficit—through either tax reduction or increased spending—would be antideflationary. For the longer outlook it would tend to be inflationary unless a budget surplus is achieved when business activity again approaches a new high level. The inflationary potential would be reduced to the extent that Treasury issues for new money were sold to investors and not to commercial banks. Also, taxpayers should be relieved of the burden of supporting waste, extravagance, and inefficiency in the operations of the Government.

6. (*a*) I am not quite clear as to whether No. 2 means stability without growth, or stability (as opposed to ups and downs) in the pattern of growth.

Assuming the latter, the ideal would be steady growth with a stable price level. So far this has never been accomplished except for relatively short periods.

(*b*) Since World War II we have escaped a major depression like 1920–21 or 1930–33. In other words, during the decade 1947–57 the fluctuations in economic growth were moderated, though not eliminated. It should be recognized, however, that a succession of stimulating factors occurred—e. g., catching up with postwar shortages, the rapid rise in defense spending in the Korean War, and the boom in business capital outlays in the past few years.

As to the most recent 2 or 3 years, it seems to me that the most significant factor in economic growth was the boom in business spending for new plant and equipment, coupled with extensive research and development of new and better products and methods. The main reason for rising prices was the wage-price spiral, as already indicated. Late in 1957 the growth trend was temporarily halted with the onset of the third postwar recession. Capital outlays turned down; overcapacity became evident in various industries; inventory liquidation commenced because stocks on hand had gotten out of line with sales; and consumers, being well stocked in general with durable goods, were price conscious and less inclined to borrow for the purchase of automobiles, furniture, appliances, etc.

7. In terms of the gross national product, current Federal, State, and local spending are plus factors because they are showing a ris-

ing trend during the present business recession. But in terms of a private enterprise system, reliance in the long run must be placed on business initiative and resourcefulness, rather than on governmental spending. The rise in our standard of living has been based on industry's ability to increase production per capita, i. e., to turn out more goods for more people.

8. Current tax rates tend to discourage the initiative of persons in the higher income brackets. Depreciation allowances for business concerns are inadequate. The capital gains tax tends to freeze securities in strongboxes; if reduced, it might actually produce more revenue through increased volume of sales to realize profits.

9. Fiscal policy deals with Federal receipts and expenditures—the Federal budget—and the management of the public debt. Monetary policy regulates the amount of reserves of member banks at the Federal Reserve banks, which in turn affects the amount of bank credit available. The two should work in harmony; e. g., if credit restraint is the proper policy at a given time, the Treasury should avoid inflationary deficit financing. Both fiscal and monetary policies should encourage increased saving. Investment growth should be financed by the use of savings rather than by excessive bank credit, because the latter increases inflationary pressures. A lengthening of the average maturity of the Federal debt is desirable, to avoid too-frequent trips to the money market which tend to hamper the carryout of monetary policy by the Federal Reserve System.

10. (*a*) Good results depend more on how the monetary system is managed than in the system itself. Through a long period of trial, dating back to 1914, the Federal Reserve has developed into a satisfactory system of credit regulation. It should retain its independence of judgment, and always be free from political influence.

(*b*) Here again it is more a question of management. Improvement could be made through tighter budget control, closer supervision of the budget by Congress, and better coordination of budget policy with tax policy.

11. (*a*) When business is declining, hourly wage rates remain rigid or even advance through escalator clauses. Management therefore tries to maintain prices. Even so, sales decrease and profits are squeezed. To make dollars of income match dollars of outgo, the latter is reduced through lower dividends, shorter workweeks, layoffs, and postponement of plans for capital expenditures.

(*b*) The idea that a gradual inflationary trend is desirable (or necessary) is a dubious doctrine. It means a serious erosion of the buying power of savings over a period of years. Also there is danger that the public will catch on, and attempt to convert money into goods before the purchasing power of the dollar declines further. In this way creeping inflation would become a gallop.

12. Long-term growth of private debt is not alarming, but is a normal feature of economic growth. However, the rate of expansion in recent years has been rapid and could probably not be sustained. When recession comes and incomes are reduced, the debt burden becomes correspondingly heavier. People therefore reduce their purchases, particularly of durable goods like automobiles, until their debt is worked down. As an example, heavy borrowing on installment enabled the public to buy nearly 8 million new passenger autos in

1955. Otherwise, some of those cars would have been purchased in succeeding years. With 1955 cars still in good condition, many owners are not buying 1958 cars.

13. If a recession does not go too far, Federal action may not be required. If a major depression is threatened, the Government is committed to act. A tax reduction would probably bring quicker results because it could be made effective immediately and thus raise buying power all at once. The difficulty with increased Federal spending on public works is in the timing. There are inevitable delays, and the results are likely to come along in driblets, which may be insufficient to turn the tide. Some actions, such as the speeding up of military orders already planned, can be helpful.

14. The deficits during the Korean war had an effect on rising prices during that period. Little effect since then, except indirectly through spending for military hardware which furnishes protection but is not available for civilian economy.

15. I doubt if completely full employment is possible over a period of time. But it might be possible to keep unemployment at a minimum of 2 or 3 percent of the labor force, and still maintain a relatively stable dollar, if wage increases were limited to not more than the advances in output per man-hour and if the Federal budget were kept approximately in balance.

16. No.

17. Among the more important causes were:

(*a*) Downturn in business outlays for new plant and equipment.

(*b*) Too much inventory buildup.

(*c*) Slump in residential construction.

(*d*) High level of consumer installment debt plus ample quantities of durable goods (autos, appliances, furniture, TV sets, etc.) in consumers' hands. Result—postponement of purchases of such items until debt worked down.

My very best to you.

Sincerely,

GEORGE GUND, *President.*

STANDARD OIL CO.,
New York, N. Y., May 1, 1958.

Hon. HARRY F. BYRD.,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: Mr. M. J. Rathbone, to whom you sent your letter of February 17, has not yet returned from an extended business trip abroad, and I thought I would write you rather than defer our reply any longer. In doing so, I have taken your suggestion that we regard the list of questions as a guide and, rather than answer them point by point, have sought to express my views as a businessman on the major issues which they encompass.

An evaluation of the financial institutions of the United States and of measures to be taken in dealing with the current situation should be viewed in the perspective of our longer range economic objectives, and not from the standpoint of expediency. Otherwise we may create more problems than we solve. Because of this, I have devoted a considerable part of this letter to the long-range aspects of our economy in addition to dealing with the present recession.

All of us recognize that the basic purpose of any economic system is to fulfill, as much as possible, the needs and desires of all the people whom it serves. I know you will agree that in practice the system which we have in the United Staes, despite imperfections, has done this far better than any other system yet devised. Therefore, I believe our primary objective should be to preserve the fundamental competitive, enterprising characteristics of our system. We should not, of course, reduce our efforts to strengthen it, but we must constantly guard against courses of action which, in the long run, may impair or destroy the very thing we seek to improve.

Our Nation has been wise in recognizing that individual freedom and the spiritual and material benefits which flow from it should not be interfered with lightly. While modern life makes the intervention of government in individual daily lives unavoidable, such intervention should be kept to a minimum. In its economic aspects, it should aim primarily at the establishment of a climate which will give maximum free play to competitive economic forces. For this reason, I feel that monetary and fiscal measures which apply to the business community as a whole are usually better than specific controls, since they give the greatest scope for countless individual decisions within a general framework and do not depend on centralized decisionmaking. In avoiding such centralization, I think it is important to keep in mind the need to reverse the disturbing trend of recent years during which the Federal Government has continued to take over areas of jurisdiction and functions previously regarded as the province of the individual States.

In my view the following economic objectives are important both in themselves and to the preservation of our system:

(1) Growth in the output of goods and services, not merely to keep pace with the growth in population but, more importantly, to provide a rising standard of living for all.

(2) An institutional climate in which labor, capital, management, and the consumer all have an opportunity to obtain a reasonable share of the fruits of improved productivity.

(3) A high average level of employment and a high average level of utilization of our capital equipment.

(4) Avoidance of the erosion of the purchasing power of money through long-run price inflation.

There are, of course, other aspects of national policy which have far-reaching effects on our economy and on its survival. Paramount among these are an adequate national defense and an international economic environment in which the nations of the free world can grow and prosper. The importance of these is such as not to require elaboration.

I think the United States has done a reasonably good job of working toward at least some of the above objectives in the postwar years. From 1947 to 1957, total output of goods and services rose by about 45 percent in dollars of constant purchasing power. Despite a large rise in the population, real output per capita increased 21 percent. These increases, which have simply extended the gains which have been going on for generations, were achieved without any serious business cycle fluctuations. For example, up to this year, unemployment during the postwar period averaged only about 4 percent of the labor force, and even in the worst years of 1949 and 1954, it did not average above 6 percent. Progress toward the attainment of these objectives was made, however, at the expense of price inflation; consumer prices, for example, rose more than 25 percent in this period, a rate of rise which I believe we can ill afford for the long run.

In evaluating the results of the past decade, it may be worth keeping in mind that in the Employment Act of 1946, the achievement of a high level of employment was singled out as an objective of economic policy. By implication, the objective of avoiding inflation, as well as the other objectives mentioned above, were regarded as of lesser importance. I fully believe, however, that we should regard all four of these goals as being of the same order of importance. Admittedly, it is a difficult job to strike a proper balance between them; if one of the objectives is regarded as paramount, at least one of the others may suffer. The experience of the past decade bears this out. There is, nevertheless, no necessary reason why a reasonable balance cannot be achieved, and our policies should aim at finding this balance. As a first step in this direction, I recommend that the Employment Act of 1946 be amended to identify national policy with a fuller and more balanced set of economic objectives.

In my view, the evils of inflation should be given special attention. Continuing inflation is detrimental to our long-run growth because it destroys confidence in the future, causes real hardships for a large number of people and dissipates the will to save, which is important for financing our capital requirements. For many of our industries it raises the prospect of being priced out of important export markets. Our present inflation is the product of many factors including, particularly in recent years, wage increases in excess of overall gains in pro-

ductivity. Labor, capital, management, and the consumer all have a stake in this, and in the long run all stand to be harmed if any one group has an unequal bargaining advantage. This is one of the principal reasons for my feeling there is need for placing legal checks and balances on the powers of labor organizations. The formation of national and international unions by trades and by industries, and their federation into huge combinations, especially when supported by compulsory union membership and the checkoff system, has resulted in a concentration of power which can, and has, threatened the health and progress of our economy.

As far as antirecession measures are concerned (and I am still speaking in terms of fundamental strategy for the years ahead), it must be recognized that each recession is different and for that reason most steps taken must vary with circumstances. While forces which come into play gradually as needed, such as unemployment compensation, have a cushioning effect, I think we should continue to rely principally on discretionary measures. The most important of these are in the areas of monetary and fiscal policy. Much has been made in recent years of the reduced effectiveness of monetary policy, but I believe that control over the supply of money and the conditions of credit can, if properly used, be a highly useful tool in shaping the economic environment. The two principal fiscal tools, i. e., variations in government outlays and changes in tax rates, can also be effective. In using both types of discretionary measures, however, careful thought must be given to their long-range effects and not solely to the more immediate results.

To the extent that Federal, State and municipal government spending on useful and planned projects can be accelerated to fight a recession this should be done. Nevertheless, stepped-up public works outlays which cannot be easily curtailed once recovery gets underway should be avoided, for these carry the potential of increased inflation later on. For this reason and because it is not easy to carry an assortment of public-works projects on the books for emergency use only, accelerated spending on such projects is probably of only limited usefulness as an antirecession device.

Federal, State, and municipal governments can make their greatest contribution in this area by so programing public works as to allow a reasonably stable outflow of funds over the years. Outlays on schools, roads, and the like should be based primarily on a careful assessment of the Nation's changing requirements and resources. So handled, they would provide a steady underpinning to the growth in the economy. This should be the primary concern. Only those anticyclical changes in the rate of outlay which are consistent with this purpose should be undertaken. Along the same line, recessions should not be used as pretexts for instituting social reforms; these should be decided upon deliberately on their own merits and in the light of long-range goals and costs.

In a similar manner, business concerns should program their capital projects over time in a steady spending stream consistent with their own long-range objectives. This, too, would underpin demand for and growth in the Nation's fixed capital equipment which is necessary for economic expansion and for improvement in the standard of living. Business should keep its sights on realistic long-range objec-

tives and should avoid the excesses of wishful optimism during boom years which lead to overinvestment in new capacity. It should also avoid a panicky slashing of capital investment at the first sign of a recession. In a recession, business, instead of passively trying to ride it out, should aggressively fight it through flexible pricing policies and more aggressive selling tactics. Efforts should be made to sustain capital expenditures by shifting emphasis from expansion to cost reduction and to the introduction of new products. I think that an ever-increasing number of businessmen are recognizing their responsibilities in all these areas and are backing their convictions with action.

A general tax cut as an antirecession tool can sometimes be helpful. However, this measure, as is also true of public works, carries with it the possibility of intensifying inflationary pressures. Consequently, at any particular time there must be a careful weighing of the relative needs of stimulating the economy and of fighting inflation.

I think that for the long run, however, we should not lose sight of the fact that taxes, by their nature, are restrictive in their effects on economic activity. Over the years we should seek to reduce both tax rates and the magnitude of all Government spending in relation to total spending. We should strive to do this in an orderly fashion so that over an extended period of time the Government budget will be kept in balance.

I strongly believe we are badly in need of a reform in our overall tax structure, including corporate, excise, and personal income taxes. For example, with respect to the effects of personal income taxes, I am convinced that in large measure many of the advances which have been made in our national standard of living have had their origins in the creative efforts of unusually talented individuals. Until quite recently these people had the prospect of substantial financial reward as one of their incentives. But with the advent of steeply progressive income tax rates, this incentive has been greatly impaired. We have drifted too far from the concept of relating financial reward to results and too close to the concept of relating it solely to effort. Another pressing reason for tax reform lies in the need to assure an adequate flow of risk capital into new ventures. I have in mind not only the entry of more firms and individuals into existing industries, but also the entry into completely new fields where the risks and losses are bound to be high. In many instances, the tax structure now in effect reduces the potential payoff of success to a point where the risks are not justified. Moreover, if there is no improvement over a period of years, there will be a further decline in the opportunity for accumulation of risk capital, and thus even the question of making a choice as to its investment will tend to become academic.

Recessions, difficult and even painful as they may be, do serve the function of shaking out of the economy excesses and abuses which have crept in during previous boom periods. Business organizations and labor groups must be kept responsive to the needs of the consumer. We should strive for this flexibility while minimizing the economic waste which accompanies recessions, even though it may be impossible to achieve complete success.

In view of the many and complex difficulties which exist in all areas of economic policy, it is vital that we give our best thoughts to the

matter. I should think it a wise step, therefore, if some sort of economic commission were appointed with the responsibility for making specific recommendations on steps which might be taken by business, labor, and government to promote steady progress toward attainment of sound economic goals. Such a group should consist of individuals of outstanding knowledge and integrity drawn from government, business, labor, and the academic world.

I would now like to turn to the question of the recession in which we find ourselves today and outline briefly the measures which I believe might be taken to overcome it.

I think that business should intensity and broaden its efforts in the following areas:

(1) Undertake aggressive sales campaigns.

(2) Improve products and reduce costs so as to be able to offer the consumer better quality, lower prices, or both.

(3) Carry forward capital expenditure programs at a reasonably high level in lines where excess productive capacity does not presently exist or where there is a reasonable expectation that excess capacity will be substantially reduced in the next year or two.

(4) Be outspoken in conveying to the general public and to employees information: on the measures which business is taking to fight the recession; on the fundamental overall soundness of our economy; and on the bright outlook for long-term growth.

For the Federal Government, in addition to the steps already taken, I think:

(1) There should be a step-up in the timing of expenditures for those Government projects which have already been approved on their own merits. However, expansion of expenditures through the undertaking of new projects of dubious merit should be strongly resisted.

(2) A percentage reduction across the board in personal income taxes should be considered if the decline in consumption continues much longer. Reduction or removal of selected excise taxes should also be considered at the same time.

(3) Action should be taken to urge the individual State governments to extend the duration of unemployment compensation benefits, but Federal funds should not be used for that purpose.

Thank you for providing this opportunity to pass along my views on these most important issues.

Sincerely,

EUGENE HOLMAN.

SWIFT & CO.
Chicago, Ill., March 25, 1958.

Senator HARRY F. BYRD,
Senate Office Building,
Washington, D. C.

MY DEAR SENATOR BYRD: Mr. Jarvis, to whom you addressed your inquiry requesting expressions of opinions on vital matters affecting our economy, referred the questionnaire to me and I have reviewed with him the attached answers. I trust you will find them useful.

Very truly yours,

H. B. ARTHUR.

ANSWERS TO INQUIRY OF SENATOR HARRY F. BYRD, SENATE FINANCE COMMITTEE (FEBRUARY 17, 1958)

1. Give a definition in your own words of deflation and inflation.

Inflation is an excessive and unsustainable expansion. It is an expansion that is usually attended by increases in prices and expansion of monetary and credit instruments. These aspects of the economy expand more rapidly than do the production and flow of real goods and services. Deflation is the converse of inflation.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

Many stabilizers (both those that are built in and those that are affirmatively managed) exist in the United States economy. Governmental activities are only an adjunct to other forces. I believe that present laws are adequate for the most part although there are some built-in unstabilizers in our progressive tax system and elsewhere. Fiscal and monetary measures are the most appropriate and powerful governmental instruments for affirmative management actions by the Government. The great danger in governmental policy is the very strong bias of nearly every political pressure in the direction of letting inflation run because it feels good, even though it may have harmful longer run effects.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised with the following years: 1942 to 1957. (You may wish to divide the period into two parts, 1942–50 prior to the accord, and 1951–57.)

On the whole, it seems to me that the Federal Reserve System has operated with reasonable intelligence, although its soft money policies in the period 1942–50 undoubtedly reflected a willingness to absorb a certain amount of inflationary credit expansion as a part of our abnormal wartime condition.

4. Beginning in August 1956 there was an increase in the consumer price index each month through September 1957, thereby causing a

decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar.

There were no doubt many factors contributing to the decline in the value of the dollar during the period August 1956 through September 1957, although I am inclined to put greatest emphasis upon the "cost-push" effect of wage increases.

5. What effect does the management of the current public debt have upon the national credit structure and the economy of the United States?

The public debt is high. It forces a substantial portion of the flow of our national resources into the servicing of that debt. At the same time it is an element that would permit a firm debt management policy to exert a considerable influence upon the future expansions and contractions of our economy. This is one of the powerful tools for economic management and it requires the utmost of sound judgment and professional integrity for its proper handling.

6. (*a*) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

1. Price stability.
2. Stability of production, demand, and employment.
3. Economic growth in production, demand, and employment.

In respect to our national economic policy, the three objectives mentioned in your question are all-important and all of them are closely interrelated. Perhaps the ultimate objective is that of maintaining economic growth with a reasonable degree of flexibility in the short run rather than such rigidity as will not allow us to accommodate ourselves to change. Price stability is rather a result than a cause; it reflects how well and how constructively the other objectives have been attained.

Many efforts have been made to establish by law statistical or rule-of-thumb criteria, including such terms as "full employment" or "parity," each with more or less definite statistical specifications. Such yardsticks are almost invariably targets for political pressures on the part of those seeking, as it were, to raise the temperature by lighting a match under the thermometer. Since these criteria are subject to pressures that are almost certain to be unstabilizing and inflationary, the only feasible procedure would seem to be the placing of broad powers in the hands of authorities whose sole responsibility is the public interest and who are insulated, as far as humanly possible, from the continuing pressures.

(*b*) With respect to these 3 objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II—during the most recent 2 or 3 years—and especially during 1957.

My only comment on postwar and recent experience is that we have granted such special privileges to certain elements in our economy that we have created a chronic pressure toward imbalance, both in the wage market, and in our international economic relations. In spite of these qualifications, we have made very substantial progress since the war in developing some basis for confidence that the sort of collapses that occurred in 1920 and 1932 are not the great threats they formerly were.

7. Give your opinion of the effect on our economy of current Federal, State, and local government spending.

I do not believe that Federal, State and local government spending should be carried on for the sake of doing some spending. It is rather a matter of performing necessary governmental services and this should be the controlling criterion. The timing of spending can possibly be made countercyclical in its impact but the danger is that it will merely be progressively expansive once it is unleashed in the guise of a countercyclical weapon.

8. Give your opinion of the effect on our economy of current Federal, State, and local taxation.

Taxation is the way we pay our bills. I believe that the method of taxing should be basically economic rather than socialistic or egalitarian in its focus. As to the level of taxes, we should pay our bills and reduce our debts, except in periods of emergency. Taxes ought not to be used to curry favor or to penalize the unpopular.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes, and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

No comment.

10. (*a*) Comment generally on the adequacy or inadequacy of the United States monetary system. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits.) Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

On the whole, our monetary system seems adequate. The rigid discipline of the traditional gold standard may have been so inflexible as to produce periodic collapse. On the other hand, it is unfortunate to have nothing but discretionary declarations as the basis for confidence in making long-time commitments in monetary terms. Perhaps the latter is the best we can do but it requires the establishing and cherishing of a tradition of monetary integrity which unfortunately has proven most difficult to maintain under any form of government.

(*b*) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

No comment.

11. (*a*) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy.

It does not seem to me like there is even a paradox in having inflation and unemployment at the same time since inflation may be purely monetary—a matter of marking up price tags—whereas unemployment may be a direct result of having put prices out of reach of those whose jobs and incomes depend upon a continuing movement of goods.

(*b*) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full-employment goals?

We should never accept creeping inflation. We may get it as a result of other forces and against our wills, but to prescribe it or to accept it can readily be as fatal as the opening of Pandora's box or the adoption of a dope habit.

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy?

I am not nearly so concerned with the extent and the unstabilizing impact of the growth of private debt as I am with the need for us to analyze it more carefully and to secure full information about its volume and the points at which it will exert pressure under conditions of stress and change.

Apparently, consumer installment credit is much more stable than people had assumed and isn't something that leads to breakdown and mass repossessions, at least in periods of moderate readjustment. Mortgage credit is undoubtedly much less vulnerable than in the 1920's before the common practice turned to amortized mortgages.

There are, however, many forms of credit which are less publicized and may contain some cause for concern. I am referring to such things as sale and leaseback practices, supplier or customer credits in various kinds of agricultural and business operations, the practice of equipment leasing, etc. I have no conviction that these practices are unsound or dangerous at the present time. I am much concerned, however, that there is so little known about their magnitude and significance. Many leaseback arrangements impose an obligation on the lessee which is as rigorous as a bond or note, but the principal amount does not, in many cases, appear in published balance sheets. Similarly, we know that large losses have been incurred in past periods of stress in various intermediate financing operations, whether it be in the provision of earth moving equipment in the construction industry or feed loans to farmers.

The above is primarily a plea for better information and study.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy.

I see no fixed point that can be defined in specific terms. Certainly, massive Federal programs should be delayed until obvious excesses have had time to be assured of correction—otherwise only greater future grief will be stored up by the measures your question implies. Moreover, any truly constructive action should include solid incentives as well as cushions, palliatives, and relief. Among incentives, I would include those measures which would provide more attractive investment opportunities and profit prospects.

14. How much of a factor, in your opinion, has deficit spending by the Federal Government since the end of World War II been in contributing to or producing inflation?

Deficit spending has, of course, been a contributing factor. However, much of the deficit spending that has shown up in the past decade in the form of inflation was actually spent or "planted" during the war itself. In other words, there was a great deal of spending and many commitments that could have been mopped up or liquidated in the early postwar period when deferred individual and corporate spending were being expanded so rapidly.

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

This depends upon whether we are willing to be realistic and recognize that full employment, as we measure it statistically, has to allow for somewhere between 3 and 5 million who will be classified as unemployed even though for practical purposes we have a fully employed labor force. With this modification, plus a realistic recognition (particularly by labor unions) that wage rates cannot be pushed up faster than total national productivity without resultant price inflation, it would be possible to answer your question in the affirmative. However, these are pretty important reservations.

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

Certainly the question is not one of logical incompatibility since escalation—meaning the adjustment of wage rates to changes in the price level—would be neither helpful nor harmful if we had general economic stability, including stable prices. However, if escalation is established on a one-way basis, like a ratchet, then it is going to introduce an important unstabilizing bias.

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.

To date the present recession does not seem to have gone beyond the point of healthy correction that any dynamic economy ought to expect to go through from time to time. We are correcting various kinds of excesses and so long as we avoid the impact of too many simultaneous corrections and a resultant cumulative decline which feeds on itself (without correcting anything), we need do little more than provide psychological assurances that powerful weapons are available to prevent the excesses from running unchecked in the direction of contraction. This is about where we are now. It imposes a delicate and difficult task for any governmental instrument that attempts to govern the balance wheels. This is perhaps the greatest danger we now face—that control policies may backfire or go awry.

CHICAGO, ROCK ISLAND & PACIFIC RAILROAD CO.,
Chicago, March 25, 1958.

Senator HARRY F. BYRD,
Chairman of the Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: I have your letter of February 17 in which you ask me to give you my thoughts and opinions about certain vital matters associated with our economy.

I am not a trained economist. Particularly, I have not made a study of the phases of the economic situation which are presented in questions 2, 3, 5, 6, 9, and 10 (*a*) of the list of questions which accompanied your letter. I believe that I am competent to answer with a greater or less degree of accuracy the other questions which were presented by you.

Question 1: A short time ago (before receiving your letter), I read a booklet entitled "The Economics of the Money Supply." The first paragraph of the introduction to this booklet read as follows:

"A dollar is always a dollar, but sometimes it is alleged that it is a 50-cent dollar. The reference, of course, is to its purchasing power. This varies depending primarily on Government policy with respect to expenditures, taxation, debt management, and credit expansion."

While in the paragraph above, the statement is made that the purchasing power of the dollar varies depending primarily on Government policy, there was nothing in the booklet itself to indicate that any other factors had any influence at all on the purchasing power of the dollar.

Prices should, according to the booklet, rise or fall with increases (inflation) or decreases (deflation) in the quantity of money or credit. During the past few years, I think that prices have responded to inflation as, according to the theory, they should. But I do not believe that, on the deflation side, the theory would operate as freely or extensively now as it did in prior years to cause reduction in prices. Support of some prices, high taxes, high debt charges, high costs of production, and the increase in the number of wage earners covered by wage contracts which would be protected by every power at the command of the labor organizations would operate as forces against a reduction in prices and wages, even if the supply of money and credit should decrease. If they did not prevent reductions in prices, these forces would tend to diminish, following and not preceding or accompanying price reductions.

Over a long period of time, a reduction in the supply of money or credit might result in some reduction of prices, but I am satisfied that the pressures mentioned above would make most difficult, if not impossible, a substantial and immediate reduction of prices. After all, prices cannot go below the cost of production for very long. The length of time prices could remain below cost of production would

vary from enterprise to enterprise. (One alarming fact—alarming from the point of view of the Treasury of the United States—is that reductions in prices without reductions in the costs of production will reduce income-tax payments.)

Questions 4, 11 (*a*), 15, 16, and 17: I will comment on the paragraphs numbered above at the same time because I think they are directly related.

In my opinion, the increase in the consumer price index of the past 2 or 3 years has been caused by a combination of a number of factors, including past money and credit inflation, demand for goods, large capital expenditures, Government spending, and wage increases and fringe benefits exceeding increases in productivity. Consequently, prices of intermediate products increased. Price increases in many industries affected materal costs in other industries. Prices of materials and services were increased to the ultimate consumer.

I would like to take the railroads as an example of the effect which wage-and-price increases have had. In November of 1956, all the railroads made agreements with employee organizations calling for hourly wage increases of 10 cents and an additional 2½ cents per hour for health and welfare benefits or in lieu of such additional benefits in November of 1956; of 7 cents in November of 1957; and of an additional increase of 7 cents to be in November of 1958. The agreement also called for increase of 1 cent an hour for every increase of one-half point in the consumer price index. These cost-of-living increases have already amounted to 8 cents per hour, and it is apparent that a further cost-of-living increase will be due May 1, 1958. To date these increases have totaled overall 27½ cents an hour, or over 12 percent.

These wage increases of 1956–57 were, however, the last of many wage increases since the end of the war. Since 1945, the last year of the war, wages per hour paid for, including payroll taxes and health and welfare benefits, have increased about 155 percent while prices of materials and supplies used by railroads have increased 106 percent. (The 106-percent increase reflects only average prices during the year 1957, not the prices at the end of the year.) During this period of time, gross-ton miles per hour paid for increased about 46 percent. Revenue for hauling a ton of freight 1 mile increased by 50 percent. During this period, capital expenditures of nearly $13½ billion resulted in great economies in operation and in vastly increased efficiency which enabled the railroads to do as well as they have in the face of these increased costs.

Of course, increases in cost of materials and supplies and wages affect different industries in different ways. The railroads pay out close to 52 percent of their gross revenues in wages, payroll taxes, and fringe benefits, and a little over 20 percent for materials and supplies. Many other industries pay out smaller amounts for wages and larger amounts for materials and supplies. Thus in a period of advancing wages and prices, the effects on the cost of producing the end product of an industry, services or materials, will vary.

The railroads were unable during the period from 1945 to pay these wage increases and price increases out of income at the then levels of their freight charges and passenger fares and, as a consequence, they have from time to time secured permission from the Interstate Commerce Commission to increase their freight rates and passenger fares

to some extent, even those increases which they have secured have not sufficed to provide the revenue to pay the increased wage bill and the increased prices which they have had to pay for their materials and supplies, and to yield a fair return on their investment after paying income taxes.

The railroads were required to dispense with as many employees (since 1945 the number of employees has decreased over 30 percent) and to curtail such purchases as they could, but even the combination of reduction of employees, reductions in purchases, increases in efficiency due to large capital expenditures and increased freight rates and passenger fares have not been sufficient to enable them to meet the increased costs and to earn a fair return.

The story of the past 12 years is this: Basic industries raised their prices as a result of their increased wage and material costs; the prices of other commodities went up as a result of increases in their material and wage costs; the costs of operation and prices of retail and service industries went up; the consumer price index went up; employees of many industries got wage increases by negotiations and employees of some industries got, in addition, automatic increases based on the upward trend in the cost of living—and thus going the full circle—the increases in wage and material costs resulted in higher prices to the final consumer and these prices influenced the consumer price index, producing another round in wage and material cost increases so that inflation fed on itself.

So long as the condition exists of increases in wages and additions to fringe benefits uniform across the board in all industries—basic, consumer goods, retail and service—without relation to increases in productivity of those industries and hence their ability to absorb the wage increases without increasing their prices and with many wage levels tied into the cost of living, I see no end to inflation.

The fact is that some employers can raise prices as high as the traffic will bear while others, such as the regulated railroads, cannot. Competitive forces also prevent companies in some industries from raising prices. Their only defense is reducing expenses by reductions in purchases, reduced inventories in some cases, and in the number of employees. The railroads are prevented from raising their fares and charges as they will both by competition and government regulation.

Again, railroads have obstacles in the way of reducing expenses which other industries do not have. A company which has several plants can close down whole plants and concentrate the operations at a few of the plants. A company having several production lines handling the same product can close down one or more of the production lines. In many cases the railroads cannot reduce expenses because of the requirements of law that they maintain certain facilities and services and, again, must maintain large parts of their properties however little use may be made of them. Thus the tracks must be maintained even though traffic falls off. With so many of the expenses of a railroad fixed, opportunities to reduce their expenses are limited. This explains why with the reductions in gross revenues in recent months, the drop in net income of the railroads has been most drastic and proportionately much greater than the drop in gross revenue.

I think that the explanation of the seeming paradox that at times inflation, and its resulting high prices and wages, and unemployment

exist side by side in our economy is that increases in wages and in the prices of the materials they use affect all employers. The dollars of the employer can go only so far in paying wages. The end result is that the employer's dollars simply have to be divided among fewer people and unemployment results. Again, certain segments of the population cannot or will not pay the high prices and reduce their purchases. Production and employment drops.

I know that the statement I made in the paragraph above is true in the case of my railroad. We have just so many dollars to spend for employees. As wages are increased, the number of employees to receive these dollars must decrease or our dollars will run out.

Again, it is paradoxical that prices are rising in this period of reduced buying and rising unemployment. I think the explanation is that the forces which cause increases in costs are still operating.

I do not believe that a gradual inflationary trend is desirable or necessary to achieve and maintain full employment goals. To the contrary, as prices go up, certain segments of our population cannot or will not pay the higher retail prices and certain companies cannot absorb the higher costs or sell at the higher prices needed, production will drop, and with this decrease in production employment will drop.

For yet another reason, a gradual inflationary trend is, in many cases, not conducive to full employment. This phase of the matter is one of the most perplexing problems facing industries, and particularly railroads. Theoretically, depreciation charges deductible for income tax should furnish enough money to buy a new machine or a new building when replacement time comes, but in a period of rising prices the amount recovered through depreciation will not buy a replacement; indeed, in many cases, the amount recovered through depreciation will not equal the downpayment on a replacement (I recognize that the replacement in many cases is a larger and better built article than the original but the principle still holds true because a replacement in kind would cost more). Taxes being what they are and profits so low that they do not provide funds for replacement, new capital must constantly be secured and, in the case of many industries including the railroads, this capital must be borrowed since equity capital cannot be secured. The result is that in these industries, capital improvements, including replacements, are held at a minimum. This higher and higher cost of replacement is a constant brake on employment.

Finally, rising prices impair or, if the price rise is steep enough, destroy capital—and the best example of this is the E-bond. After paying tax on the $25 profit on an E-bond bought in the 1940's, the proceeds of the E-bond is worth little more, if any, than two-thirds of the original investment of $75. Shrinkage or destruction of capital by inflation is certainly not conducive to good conditions and full employment. There is only one way in which improvements can be made and expansion obtained with outside funds and by means of which people can be employed, and this is through use of the savings of the general population. Why save if inflation will eat up the savings?

Further, there is no such thing, in my opinion, as gradual inflation. It will, as I pointed out above, feed on itself at an accelerating pace.

I do not know that full employment goals can be attained and maintained always while maintaining a dollar that has relative stable purchasing power but, I believe, for the reasons which I stated above, that there are insurmountable obstacles to maintaining full employment with a dollar which is always decreasing in purchasing power.

Escalator provisions in wage and other contracts are not compatible with achieving economic stability for the reasons which I have given in discussing that fact that inflation feeds on itself.

I know the argument is made that wage increases must keep step with the increases in the cost of living in order to sustain purchasing power; however, with further increases in the cost of living following the wage increases, the whole scheme is self-defeating.

Questions 7, 8, 10 (*b*), and 13: I have heard the argument that high taxes and spending by the Government of the money secured by high taxes is deflationary because it leaves the American taxpayer with less money to spend unwisely. Personally, if spending produces high prices, I cannot see what difference it makes, so far as prices are concerned, by whom the money is spent.

I am also certain that the Rock Island Railroad could spend money, more money than it is spending, on improvements and additions and betterments to its property which would produce greater good, not only for the railroad but also its employees and the shipping public, than is produced by many expenditures of the same and larger amounts of money by Government, Federal, State, and local.

In my opinion, the taxing policy of the Government, Federal, State, and local, is inflationary. Our local taxes are a fixed item of expense which must be met. They are met in our case by as efficient economic operation of the railroad as possible, by reduction in the number of our employees, or by higher freight rates. Our efforts along this line have not proven successful.

The income tax is especially burdensome. Every time we save a dollar in our expenses, the Government gets 52 percent of the result of our efforts. This is indeed discouraging. There is, of course, another side of the coin. In times of prosperity there have been many expenditures made on the theory that the Government would pay for 52 percent of the expenditure. On my railroad, we have fought this tendency constantly. I think from what I have heard and read that it has been more widespread in other industries than in the railroad industry because for many years the railroad industry has not been prosperous and has desperately needed the 48 cents.

In your question 13, you asked at what point the Federal Government should move in major ways, as tax cuts and/or large increases in public works, to counteract the downturn in economy. A reduction in taxes would put more purchasing power in the hands of the people. A reduction in taxes, however, without reducing Government expenditures could mean only an increase in public debt. However, the proposals of which I have heard call not only for tax reductions but also for increased spending by the Government. If, in addition to reducing taxes, the Government should increase its expenditures, this would be even more serious because it would mean still further increases in the public debt. The interest charges of the Government would increase. All hope would be abandoned of ever reducing the public debt.

The situation discussed in the paragraph above is one which, in my opinion, has been brought about by the policy of the Government to tax at the highest possible limits in times of prosperity, but at the same time spend all of the income, paying nothing toward a reduction of the debt, and then in time of recession, having little or no option as to what it ought to do.

Questions 12 and 17: I think the cause of the present recession is our overspending—overspending by the Government, over expansion by industry and overspending by a lot of people, many of whom have borrowed money to buy things which they didn't need. Prices finally got out of line, inventories built up, the wants of many people for many things seemed to be satisfied, production exceeded demand, and people stopped buying. Many citizens, because of the fact that they borrowed to buy what they have bought, had no cushion. In part, this reduction in buying may have been psychological and may have been uncalled for. It was preceded by widespread questioning as to the length of the boom and when it would stop. Psychological or not, however, the buying did stop.

Some prices have come down. Some companies have abandoned their fair price standards and agreements. Apparently profits in general will suffer, but with the reduction in prices, buying may pick up. However, profits being what they are, a shrink of those profits cannot produce any great or lasting reduction in prices. Profits are essential to our capitalistic system.

I am sorry to say that I do not know how to stop the recession. I do say that adopting many of the panaceas proposed—increased Government spending, reduced taxes merely to leave more money with the taxpayer without reduced Government spending, in particular, a combination of increased Government spending and reduced taxes, wage increases for the alleged purpose of giving increased purchasing power to one segment of the population, for instance—might appear to stop it. However, these steps would simply create another inflationary condition and another and worse recession.

Very truly yours,

D. B. JENKS.

SEATTLE-FIRST NATIONAL BANK,
Seattle, Wash., March 25, 1958.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: In reference to your letter of February 17, I am pleased to enclose a reply to your questionnaire in connection with the Senate Finance Committee's investigation of the financial condition of the United States.

I feel that it is most important to mention that the financial system of our country today is certainly not the same as existed when our economy was much smaller, say, prior to World War I. The commercial banking system is now a smaller percentage of our total financial structure than it was a decade ago, and it seems very desirable, therefore, that in order for the Federal Reserve Board or other supervisory authorities to have more effective control of our monetary system, the operations of nonbank type of financial institutions should be brought within the supervisory scope of national monetary policy. As I indicated in reply to one of the questions, I believe that the Federal Reserve Board has done a very admirable job, with the legal limitations imposed and the tools available; however, it could be much more effective by controlling the volume of a broader monetary base.

We appreciate the opportunity of participating in your study of this most important subject, and if I can be of any further assistance, please let me know.

Very truly yours,

FRANK E. JEROME, *President.*

REPLY TO SENATOR BYRD'S QUESTIONNAIRE BY FRANK E. JEROME, PRESIDENT, SEATTLE-FIRST NATIONAL BANK, SEATTLE, WASH., MARCH 25, 1958

1. Inflation is a rise in price level; deflation is a decline in price level.

2. It is not possible to avoid inflation and deflation completely. They can merely be moderated; and it becomes a matter of judgment whether price stability takes priority over economic growth and stability of production and employment. Fluctuations in the price level can be moderated by (1) a compensatory budget policy—deficits when deflation is the problem and surpluses when prices are rising, (2) monetary controls which encourage or discourage the extension of credit, and (3) a better balance between the statutory rights of management and labor. There should be an elimination of monopolistic practices by labor as well as by industry. The goal should be to maintain a fair relationship between wages and the productivity of labor.

It would not be desirable, nor would it be possible in a free-enterprise system to avoid moderate ups and downs in price level which

are part of a constant pattern of adjustment. Furthermore, there is the intangible but nonetheless real factor of public confidence. The psychology of the businessmen and of the consumers is bound to play an important role in determining the direction in which our economy will move at any particular time. A method for controlling this element of public psychology would be necessary if business fluctuations were to be entirely eliminated, and such a method has yet to be devised.

3. From 1942 to 1950 the Federal Reserve System was concerned primarily with maintaining a firm price for Government securities. This may have been a necessary policy during the war years, but in peacetime it introduces a rigidity into the money market which is strongly inflationary in its impact. Since 1951 the "Fed" has made intelligent use of normal tools of monetary policy as a restraint in boom times and an encouragement to credit extension in recession periods. The supervisory authorities have done an excellent job since 1951 with the legal and economic controls at their disposal, especially when consideration is given to the limitations imposed upon monetary control by fiscal policy and the implications of the Employment Act of 1946.

4. This most recent inflationary thrust apparently was due to increases in wages at a rate in excess of increases in productivity, combined with an attempt to maintain profit margins by passing these cost increases on to the consumer. This wage-price push has only recently become the most prominant inflationary factor. During and immediately after World War II the major influence was increase in the money supply through rapid expansion of the Federal debt. Subsequently a rapid growth of private debt brough a similar result.

5. The management of the public debt, in terms of the types of issues sold, their maturities, etc., has a very important influence upon banks, and other financial institutions which hold a substantial share of their assets in Government securities. The phrase "national credit structure" probably needs further definition. We have the Federal Reserve System and the commercial banks where the effects of the management of the public debt would be more clearly reflected. However, the national credit structure must be deemed to include savings banks, savings and loans associations, life insurance companies, Government lending agencies, credit unions, small-loan companies, and a host of other elements.

There is no question but what the current public debt has great effect on the commercial banking system of the country. The effect is a good deal less, however, when the United States Government obligations are being marketed on "free" market rates rather than artificially controlled rates. Thus, at the present time, the management of the public debt (as opposed to its increase or decrease) is just one of many items to consider in determining the supply and demand of money and the resultant interest rate. The management of the current public debt is on a sound basis at the present time.

6. (*a*) All of these objectives are desirable, yet undue emphasis on any one could defeat the other two. The most important of the three is economic growth because economic growth means future increases in production and consequently improved living standards. The second objective, stability of production, demand, and employment, would have to be ranked next. By this we mean stability around

a rising trend line. Price stability, too, is important, but it has to be sacrified in part if it prevents economic growth or enforces excessive or prolonged unemployment.

In discussing the relationship of the three listed objectives of economic policy in the United States, it appears that economic growth depends upon the economic freedom enjoyed in this country. Freedom to make a profit in our economic system necessarily includes the freedom to have a loss or go broke. The freedom to produce in unlimited quantity necessarily includes a right to produce too much or too little in the form of goods. Overproduction or underproduction are relative terms, since they are always relative to the consumption of goods. The latter in turn is dependent upon the purchasing power of consumers, advertising and sales effort, and various other factors. As long as we have the freedom of production in a free economy rather than in a managed economy, we are bound to have periods of relative overproduction or underproduction which will have their effect on prices and employment in our economy.

If we were to place price stability as our primary objective, we would have to move much closer to a regulated economy with direct price and wage controls and the like. Freedom is also a relative concept, but we cannot have our cake and eat it too. We cannot both have freedom and be free from the implications of that freedom at the same time. The relative advantages of a free and therefore dynamic economy greatly outweight the advantages of a shackled and limited economy.

In reaching this conclusion, we are aware of the fact that with freedom in the economy there will be times when there are persons unemployed. It would be desirable to have freedom from unemployment along with a free and dynamic economy, but these two objectives are not always completely compatible. Adequate unemployment compensation for those persons thrown out of work with swings in our free economy might be the best solution to this problem. Such a remedy would be preferable to a more regulated economy.

The use of monetary control, and to some extent the management of the fiscal policy of the Treasury, are excellent types of indirect methods of control to use for the purpose of preventing extravagant inflation or deflation, while leaving our economy free and not "managed."

(*b*) Over the entire postwar period the objective of economic growth has been achieved beyond our fondest expectations. Stability of production, demand, and employment has also been maintained. The recessions of 1949 and 1954 were neither severe nor prolonged. The one objective which has suffered has been price stability. The current recession is in part a reaction against rising prices, and the temporary instability in production, demand, and employment is a means of slowing the price inflation. This probably means also a somewhat reduced rate of economic growth.

7 and 8. Spending and taxation must be considered together because the most important effects are felt when spending exceeds taxation, or vice versa, the former being inflationary and the latter deflationary. Apart from this rather obvious conclusion, the following additional observations may be made about Government spending and taxation:

(*a*) Heavy Government spending, as now, tends to be inflationary even with a balanced budget. This is true because the money spent by

Government is a more effective stimulus than the same money in the hands of the taxpayers who would save at least a portion of this money; also, because a substantial portion of taxation shows up in the form of higher prices. The latter is particularly true with respect to the corporate income tax since corporations measure their profits in after-tax terms and the tax becomes an element of cost which is passed on to the consumer.

(*b*) Heavy Government spending is a stabilizing influence in the economy since it does not fluctuate for the same reasons nor necessarily in the same direction as the spending of business and individuals.

(*c*) Government expenditures have some influence both pro and con on economic growth. Heavy taxation clearly tends to discourage the expansion of business and industry. On the other hand, Government expenditures for research in military and nonmilitary fields are a contributing factor in continued growth.

(*d*) Federal, State, and local taxation has exceeded 30 percent of national income in recent years. A more rational and less discriminatory tax system would release more money for discretionary investment by private citizens and help develop our free economy. It seems logical that a tax system which would give more incentive to ambitious entrepreneurs would help to develop a large economic base from which to draw the tax funds for necessary Government expenditures.

9. Fiscal policy relates to the budget, taxation, and management of the public debt. It involves such things as the budgeting process, appropriation backlogs, rate of expenditure of funds, and the sale of Government securities. Monetary policy, on the other hand, relates to the availability and cost of money and credit. On the fiscal side clearly the most important single question is whether the budget runs a surplus or a deficit. Even within a given budget, however, the timing of expenditures within the year, e. g., the speedup or slowdown of military procurement, can have quite a short range effect on the economy. The decisions of the Treasury with regard to the types of securities issued, particularly their maturity, has a good deal of effect on the availability of funds in the short-term versus the long-term market since Government securities are such an important element in both markets. Monetary policy is administered principally through three devices: the reserve requirements enforced on member banks of the Federal Reserve System, the discount rate of the Federal Reserve banks, and the open-market operations of the Federal Reserve in purchase or sale of Government securities. These can be quite effective devices for limiting the supply of credit and increasing its cost during a boom period.

By increasing reserve requirements, increasing the rediscount rate, or by selling in the open market, the Federal Reserve System has a method of reducing the loan potential of the commercial banks in the country. Of course, an increase in reserve requirements after many banks are approaching the "loaned-up" position would be a very harsh tool to use and could force disastrous liquidations of assets. If reserve requirements were on a more reasonable basis to begin with, such as the reserve plan advocated by the ABA, then reserve requirements could more properly be raised to help absorb large excess reserves at the beginning of an inflationary threat. An increase of the rediscount rate or selling in the open market are better tools to implement credit re-

striction after the inflationary trend has gained impetus. This would result in local banks screening their loans and making fewer of them. This would have a discouraging effect on expansion of business and consumer expenditures and would tend to reduce the threat of inflation. It is not so certain that the monetary controls are effective on the downturn, since the mere fact that credit is available does not mean that people will have either the need or the courage to borrow.

Selective control by the Federal Reserve can also be used to combat inflationary tendencies in particular segments of the economy. Raising margin requirements is an effective method of curbing unhealthy speculation in the stock markets. Regulation X on real estate credit and Regulation W on consumer credit may have to be utilized again in the future to avoid excessive expansion in these fields. The impact of selective controls, which affect all lenders, does point up a weakness in general monetary controls. As was pointed out in the answer to question number 2, the commercial banking system is only one portion of the national credit structure. The money and credit flowing outside the commercial banking system are not directly subject to general monetary controls. The expansion of funds handled by financial intermediaries such as life insurance companies and savings and loan associations tends to diminish the effectiveness of the general monetary controls of the Federal Reserve.

10. Both the monetary and fiscal systems of the United States today are substantially adequate. The budgeting process is extremely complicated and tends to escape control. Unfortunately there seems to be no simple solution to this problem.

11. (*a*) The paradox of inflation and unemployment existing side by side is not one which has ever existed for long, nor is it likely to. So far as the current situation is concerned, it is well to remember that we have cushioned the effect of wage losses by unemployment compensation payments. This is a very desirable thing, but it also cushions the reduction in demand which would force price adjustments. Another factor is that management policies in the large industries such as steel and autos have been directed and are directed at the present time to maintaining prices even with decreasing demand. This causes delay in the normal functioning of supply-demand factors.

(*b*) We need not accept a gradual inflationary trend as desirable or necessary. It may be that some further inflation is inevitable in the next few years, since the working age group in the population is not now increasing as fast as the total population, and will not be doing so until we begin to get the benefit in the labor force of the increased birth rate during and after World War II. The relatively short labor force of the past decade has resulted in increased bargaining power for labor and has been a part of the wage-price spiral.

It would have to be conceded that a degree of inflation might be necessary if the country were going to avoid any degree of unemployment at all. It would be our preference, however, to substitute unemployment compensation to an adequate extent, maintain a free economy, and endeavor to maintain a sound dollar so far as this was consistent with a growing economy. There would be swings in the value of the dollar, but our other objectives do not necessitate a constant weakening in the purchasing power of the dollar.

12. Private debt in the years since World War II has increased much more rapidly than the growth of the economy. This clearly is a

situation which cannot continue indefinitely. It has tended, however, to restore the normal historical relationship between private and public debt, and in fact we probably can afford to have private debt increase at a faster rate than gross national product for some time in the future. The over-all debt situation is not alarming. In some areas, notably installment credit, the increase has been too rapid at times and in effect has borrowed against the future. This certainly was the case with the rapid increase in installment credit in 1955. On the other hand, the amount of Government debt, and especially the probability of its increase rather than its payment, may eventually become a threat to the stability and vitality of our economy.

13. The Federal Government should be very cautious about moving in a major way to counteract a downturn in the economy. The operation of the Federal Government on a deficit basis will definitely have an inflationary effect. The long run threat our economy faces is inflation. Any rash moves now would fan the fires of the ultimate long-term threat. There is danger of being panicked into major actions like a substantial tax cut, or a big public works program, in order to pull ourselves out of a recession which will correct itself in a matter of months. Too rapid or drastic action could very easily put us back on the inflation treadmill which we were walking a year or two ago. No one, however, can be completely certain that the analysis of this recession as a healthy correction, not too deep or prolonged, is a correct one. Roughly the danger signals would be a reduction of 15 percent in industrial production or 5 percent in consumer demand, or an unemployment level of 10 percent. These are subjective judgments which are difficult to defend or to apply in a particular situation.

14. Deficit spending by the Federal Government since the end of World War II has had some inflationary effect, but the great increase in debt during this period has been in private debt. While Federal Government debt increased by $20 billion from 1950 to 1957, consumer debt and real estate mortgage debt increased by a total of over $100 billion during the same period. It is well to point out, however (a) that we have failed to reduce the national debt substantially during good times, and (b) that the war-time increase in the Federal debt, and particularly its monetization through the banking system, provided the base for postwar inflation.

15. Both full employment and stable purchasing power are relative terms rather than absolute. In both cases there must be moderate fluctuations, and with this understanding, they are consistent with each other. Full employment can be maintained while maintaining a dollar of stable purchasing power. The concept of full employment must be flexible enough, however, to encompass a level of unemployment and job turnover which avoids competitive bidding for labor that raises labor costs more rapidly than productivity.

It is going to take a change in public thinking, however, if both goals are going to be attained. At the time of every business downturn there will be pressure to ease monetary controls and to follow a deficit financing program by the Government. Recent history shows that when the crisis is past Congress will continue to spend all of the tax money and still may not operate on a balanced budget. Then when the next downturn in business comes, there is further deficit spending. We are going to have to face up to the situation of allowing our economy to right itself through its temporary recessions or to reducing the

public debt in times of relatively full employment if we are going to maintain the value of the dollar. As long as we continue deficit spending and never make any more than a token effort at repayment in good times, then we will have continuing inflation over the long pull.

16. Escalator clauses tied to the cost of living are not necessarily incompatible with economic stability. They endeavor to protect the employee against influences in the economy beyond his control. Escalator clauses which involve a productivity factor, on the other hand, are unsound if they allocate all of the benefits of increased productivity to labor and make it impossible to reduce prices. This clearly has an inflationary impact. Moreover, it must be recognized that the opportunity for productivity increases is greatest in manufacturing enterprises where this sort of escalator clause is most prevalent. If relative price stability is to be achieved, it will have to be through a combination of lower prices for manufactured goods where productivity can be raised, and higher prices for services where the productivity factor is pretty well fixed.

17. The major reasons for this recession are reductions in expenditures for capital goods and business inventories. These in turn reflect a rapid increase in productive capacity and the reluctance of consumers to absorb the increased output at current prices. In a large sense, what we are undergoing is a rebellion against rising prices. This is an inevitable reaction to the inflation of recent years. We apparently have reached the low point of the recession, although no substantial recovery is indicated for several months. No immediate action to terminate the recession seems advisable. If the forces of recovery are not self-generating and action is required at a later date, a substantial tax cut would probably be most effective and least disruptive to the normal functioning of economic forces.

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KAISER ALUMINUM & CHEMICAL CORP.,
Oakland, Calif., April 7, 1958.

Senator HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: I appreciate your invitation for me to express views to the Senate Finance Committee concerning financial and economic problems of the United States. There is one thought I should like to add to the vast expert and detailed comments your committee has assembled.

I believe that the beast of deflation can be worse than the beast of inflation in the consequences inflicted upon the people.

Therefore, it is vital that policies of credit and other governmental regulations not be carried to the point of artificially creating deflation and depression.

It is my firm conviction that the American people should continue, for generations to come, making tremendous forward progress throughout our economy—in industry, business, standard of living, science, the new industry of discovery, and in all fields of supplying more and more things for more people.

So positive steps should be taken to keep business, industry, and employment constantly expanding. That is the true destiny for America—expansion and growth—with always higher levels being achieved in the economy.

My sincere wishes that your committee may make some real and lasting contributions to the Nation's welfare and strength.

Sincerely,

HENRY J. KAISER.

THE B. F. GOODRICH CO.,
Akron, Ohio, April 1, 1958.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: Your letter of February 17 addressed to Mr. W. S. Richardson, who retired last August, requested comments concerning the definition of inflation and deflation, monetary and fiscal policies, and other vital matters affecting our economy.

I have attached to this letter my own comments and answers to the questions which you raised. If additional comment or information is required, you may be assured of my full cooperation.

Very truly yours,

J. W. KEENER, *President.*

1. Give a definition in your own words of "deflation" and "inflation."

Inflation or deflation is manifested in price changes. The usual definition of inflation or deflation is simply in terms of the price increases or decreases that have occurred during a given period. This type of definition is convenient and meaningful—the concept is readily understood. Actually, inflation or deflation is the complex economic-political process by which price changes occur. The useful definition of these terms must include an attempt to describe the economic process involved.

Starting first with the idea of inflation or deflation as a price change, several basic questions must be answered—for example, which prices are increasing or decreasing? The consumer usually defines inflation in terms of a rise in the cost of living or in terms of his income buying less goods and services. The manufacturer views inflation from a different viewpoint. More than likely he will define inflation in terms of price increases for those items that he is purchasing—raw materials, machinery, labor, etc. Both the consumer and the manufacturer may be aware of upward and downward movements in prices for specific items but the term inflation is generally applied only when the total dollar amounts available for spending purchase a smaller total quantity of goods and services. Thus, for the economy as a whole, inflation results when the amounts available for spending by all groups, including both earned income and borrowed funds, outrun the physical supply of goods and services.

It is my opinion that the term inflation should apply to any price increase for a given quantity of a particular good or service which does not reflect a commensurate increase in the quality or utility of that good or service. The severity of the inflation problem, then, is measured by the number and relative importance of the goods and services for which prices are increasing. For example, the decline in food prices from 1952 to 1955, probably the major factor in the rela-

tive stability of the overall cost of living during these years, tended to obscure the substantial rise in prices for many types of goods, and especially services.

In analyzing the inflation process, much of the confusion as to the cause of rising prices stems from the failure to consider the problem from the standpoint of both the manufacturer and the consumer. The manufacturer traces inflation to rising costs, since from his viewpoint inflation is manifested in rising prices for the goods and services which he buys. Moreover, rising costs largely refer to rising labor costs since employee compensation accounts for more than 70 percent of all national income originating in manufacturing industries. Employment costs for a single manufacturer may represent only one-third of the total costs for that firm but rising labor costs are reflected in the higher prices than the individual manufacturer must pay his suppliers for their products.

Incidentally, inflation from the viewpoint of the manufacturer has been a much more serious problem in recent years than inflation from the standpoint of the consumer. The cost of living rose 7 percent from January 1955 to January 1958, whereas during this same period, average hourly earnings in manufacturing industries increased by 14 percent (with little increase in output per man-hour to offset these additional costs), general-purpose machinery prices were up 25 percent, construction costs rose 13 percent, and overall industrial prices increased 10 percent.

This is the cost side of the equation. As costs to the manufacturer increase, these higher costs must be reflected in higher prices charged by the manufacturer if a reasonable profit is to be returned, and if the individual firm is to remain in business. The other side of the coin is, of course, demand—the ability and willingness of the consumer to pay the higher price. Unless the demand for the manufacturer's product is sufficiently strong, the price increase will not be effective. If the list price itself is not reduced, then the net price will be reduced through larger discounts, freight allowances, higher quality, more services, etc.

When prices rise because of inflationary wage increases (wage increases resulting in higher unit labor costs) only a portion of the consuming public enjoys an increase in income to support the higher price levels. Persons on relatively fixed incomes are forced to curtail purchases of some items. The ability of a manufacturer to pass along higher costs in the form of higher prices depends upon the strength of demand for his product relative to alternative items and the competitive structure of the industry in which he competes.

The facts indicate that manufacturers generally have been able to pass along in higher prices only a part of the cost increases. Corporate profits after taxes, for example, are estimated in 1957 to represent only 5½ percent of national income as compared with an average of 8½ percent during the years 1947–49. Because of the economic power and unrestricted freedom of organized labor, the manufacturer in effect has been forced into the position of transferring purchasing power from the shareholder to the wage earner, from persons with fixed incomes to the wage earner, and from creditors to debtors.

Inflation can, of course, originate on the demand side of the equation. A sudden rush of consumer demand, usually financed by debt creation, may result in higher prices. Demand-type inflation such as

that following the invasion of South Korea may result in a sudden increase in profits. However, experience has shown time and again that the demand-type inflation is short-lived. Pressures for higher wage rate boost costs and supply is soon increased to handle the spurt in sales volume. On the other hand, inflation originating on the cost side is the far more persistent problem. There are no automatic adjustments to offset the effects of unrestricted use of economic power on the part of organized labor or the long-range favorable demand situation for the services of labor.

Inflation, then, is really the interaction between those forces making for higher costs and the ability and willingness of the consuming public to pay the higher prices.

In attempting to define inflation and deflation I have concentrated on the inflation problem. It is my opinion that inflation represents the far greater threat to our national well being. This is not to say that in the future we will not be faced with economic declines such as at present but the cost rigidities which are a part of our economic structure tend to limit price declines. The factors limiting the magnitude of price declines during a business downturn seem to be far more effective than the factors limiting price increases during a rapid upswing in business.

I would define deflation as a reduction in the price of a particular goods or service which has the effect of reducing either labor or property income. Theoretically, prices for many types of goods could be reduced on a long-term basis as a result of increasing productivity. An increase in output per man-hour with a smaller percentage increase in hourly wage payments would result in lower unit labor costs which, in the competitive process, would result in lower prices. The process of distributing productivity gains through lower prices rather than increasing wages or profits would not result in a decrease in income but would represent a gain in real income for the general public. A price reduction, based on increasing efficiency of industry, would not be defined as deflation.

If prices are reduced because the physical supply of goods and services has outrun the amounts available for spending, the result will be lower money income. A lack of effective demand will reduce profit margins, lower production volume, and finally reduce total wage and salary payments. In a situation of relatively fixed wage rates the reduction in wage and salary income results mainly from reduced employment.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

The basic problem is not simply to avoid either inflation or deflation but to accomplish these ends without enacting a political strangehold on the competitive enterprise system and thereby eliminating economic progress. For example, I cannot conceive of any form of legislation which could be enacted in time to be effective in avoiding the demand-type inflation—a rise in prices resulting from a spurt in consumer demand. Perpetual price controls, consumer credit regulations, etc., would indeed be a drastic penalty to pay in order to avoid a situation which is soon corrected in the normal competitive process.

The same applies with respect to the problem of deflation. Shifts in consumer demand may temporarily result in an oversupply of a particular goods or service. Governmental programs to insure that prices for particular goods and services do not decline must inevitably result in a controlled economy.

There are, however, certain actions which the Federal Government and the Congress can take to discourage wage-push inflation. These actions, however, will require a fresh approach to the inflation problem. We have been attempting to deal with the problem of wage-push inflation by monetary and fiscal measures. Increases in reserve requirements, rediscount rates, tax rates, etc., however, do not deal with the real cause. They represent rather an attempt to create a counter-push by squeezing businessmen so that they will, in turn, resist inflationary wage demands. Experience of the past has shown that neither economic contraction nor industrial strife, both of which can result from this approach, have been effective as anti-inflation programs. The obvious answer is to diminish in some way the degree of economic power exercised by organized labor—reduce the pressure at its source.

To accomplish this end, it will not be enough merely to attach a few amendments to the existing body of antitrust legislation. Antitrust legislation and the usual Federal regulatory agencies were designed and operate to protect the general public from various abuses. However, present labor legislation and those agencies charged with the administration of this legislation really function to preserve legal immunities and economic power enjoyed by labor organizations and their leaders at the expanse of other groups of citizens. What is required is a new body of labor law which will shift the emphasis from the present policy to that of protecting the public from abuse by organized labor.

I do not advocate the diminution of economic power of organized labor to the point of destroying the collective-bargaining process. The threat of abuse stems mainly from the immunities of labor unions from laws and regulations which apply to everyone else, including business concerns. Roscoe Pound, former dean and professor emeritus of the Harvard University Law School, in a recent publication of the American Enterprise Association, summarizes these immunities as follows:

"1. Substantial elimination, as against labor organization, of what in practical effect is the assured method of enforcing the law applicable to everyone else.

"2. Refusal of labor organizations to be treated as legally responsible organizations by becoming incorporated and so legally tangible entities.

"3. Not distinguishing unlawful action by labor organizations, their leaders and their members, done outside of the employer-employee relation, from practices in that relation.

"4. Committing all matters affecting labor organizations to an administrative agency instead of confining its jurisdiction to matters involved in the employer-employee relation."

It is my opinion that legislative action to eliminate the immunities enjoyed by labor unions is the vital step which we as a Nation must take in order to avoid continuing wage-push inflation.

From a long-range viewpoint, the Federal Government can help avoid inflation by following monetary and fiscal policies which pro-

mote economic growth. I define economic growth largely in terms of the increasing efficiency of American industry. The postwar experience has shown that the American economy has a long-range growth potential of 3–4 percent a year; that is, the gross national product adjusted for the effects of inflation will increase on a trend basis by 3–4 percent a year. Only a fraction of the increase in our national output, however, results from the increasing size of the labor force. The bulk of economic growth stems from the ability of industry to increase the volume of goods and services produced per man-hour of labor. Increased investment in modern plant and equipment makes possible the rising trend in productivity.

The most significant contribution that business leaders can make in the fight against inflation is to be constantly on the alert and act on opportunities to improve productivity. Long-range planning of capital expenditure programs, now widely used throughout American industry, will help to promote more stable economic growth.

As long-range objectives, national monetary and fiscal policies should be determined with a view to balancing the Federal budget and to providing for a growth in the money supply consistent with our economic potential. This does not mean that in a given circumstance the budget should be balanced at all costs, nor does it mean that monetary policies should always be expansionary in character.

Our primary goal must be now, and for some years to come, to maintain a strong defense posture. However, most Federal expenditures are by their very nature inflationary in effect since they add less to the productive capacity of the Nation than would be achieved if the same volume of spending were accomplished in the private economy. It does seem possible, even at the present time, that a gradual reduction in Government spending could be achieved in many nondefense programs, particularly subsidies of various kinds, which promote high prices.

When tax reductions become possible because of increased revenues under existing tax rates or because of a reduction in expenditures, the tax reductions should be designed so as to maximize long-range beneficial effects. A major problem which faces this Nation is that of providing sufficient incentives to be more efficient, to add productive capacity, to make the necessary effort from which economic progress comes. The progression in personal individual income tax rates serves to promote inflation and to restrict incentives. Also, there exists the myth that business taxes are in some way paid out of profits without affecting the individual tax burden. In the final analysis, only individuals pay taxes. Corporate income and excise taxes represent costs of doing business and hence are reflected in general price levels. A balanced program of tax reduction should provide for a cut in business taxes as well as individual taxes.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942–57.

In retrospect it is clear that too large a portion of the Federal expenditures during World War II were financed by debt creation. During the fiscal years 1942–46 only 48 percent of the $382 billion of Federal expenditures were financed by taxes. The result was a sharp increase in the money supply from $74.2 billion in June 1941 to more than $171 billion by June 1946. Monetary policy during World War II seems to have had one purpose: to facilitate financing of the war

effort without regard to the postwar problems that were being created. The result was that monetary policies during the early postwar years could hardly be effective in controling price inflation or in stimulating business activity during the 1948–49 downturn. As long as the Federal Reserve System was required to support the prices of Government securities, monetary control policies were bound to be largely ineffective.

The accord with the Treasury made it possible for monetary policy to be effective in restricting growth in the money supply relative to the increase in physical output of goods and services. The switch from tight money to easy money in 1953–54 was taken in anticipation of a downturn prior to the fact. Experience has shown that a switch to easy money does not in any way assure an upturn in business activity but the switch can set the stage for another round of inflation when an upon turn does occur. The basic problem is, of course, that monetary controls can produce contraction in business activity, but it is possible to have a contraction in business activity with price inflation still continuing.

The recent turn of events supports this statement. It is possible that monetary policy in recent years has been to restrictive, thereby contributing to the sharp decline in industrial production in the past 12 months. From the fourth quarter 1954 to the fourth quarter 1957, the gross national product increased by almost 18 percent. During this same period, the total money supply increased by less than 9 percent, and if time deposits are excluded from the calculation, the increase was only 3 percent. Yet during these 3 years, the cost of living rose by 6 percent and industrial prices were up almost 10 percent.

4. Beginning in August 1956 there was an increase in the consumer price index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar?

The rise in the Consumer Price Index from August 1956 through September 1957 may be traced to three basic sources:

1. The 7½ percent rise in retail food prices from March 1956 to September 1957. (Food prices get a weight of almost 30 percent in the Consumer Price Index.)

2. A continued uptrend in prices for services included in the Consumer Price Index.

3. The 6 percent rise in straight-time average hourly earnings in manufacturing industries during this period with little, if any increase in output per man-hour to offset the additional costs.

The relative stability in the Consumer Price Index in the 5 years prior to August 1956 was based to a large extent upon the decline in food prices which started early in 1952. In spring of 1956, however, this trend was reversed; rising prices for services and many types of goods were no longer offset by lower food costs, thereby pushing the entire index upward.

According to the United States Department of Labor, higher wage rates in 1956 were not offset by productivity gains as in previous years. In the rubber products industry, for example, it is estimated that output per man-hour in 1956 was actually lower than in 1955, yet sizable wage increases went to organized labor during this period. The rise in prices was, of course, made possible by the generally strong

level of demand in most segments of the economy during 1956, particularly demand for capital goods. The sharp increases in plant and equipment expenditures during that year were accompanied by sizable increases in construction and machinery costs.

5. What effect does the management of the current public debt have upon the national credit structure and the economy of the United States?

Management of the public debt represents an important tool of monetary policy. When the debt is managed so as to increase the average maturity of the marketable debt, the Treasury is competing with corporate, State, and local government and mortgage borrowers for a limited amount of funds. The effect of lengthening the average maturity is to tighten the money market. A move in the other direction is consistent with an easy money policy.

Clearly, the management of the public debt should at any given time be consistent with the objectives of other instruments of monetary policy. The long-range objective of debt management should reinforce the long-range objective of fiscal and monetary policies to promote economic growth and price stability.

A gradual lengthening of the average maturity of the debt is desirable. At times, however, a temporary reversal of the long-range objective may be necessary. The lengthening in the average maturity accomplished since October 1957 has been consistent with the tight money policy during a period of sharp business contraction.

6. (*a*) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

1. Price stability.
2. Stability of production, demand, and employment.
3. Economic growth in production, demand, and employment.

(*b*) With respect to these three objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II—during the most recent 2 or 3 years—and especially during 1957.

It is my opinion that the primary objectives of economic policy in the United States should be:

1. Economic growth in production, demand, and employment.
2. Price stability.

Comments on the economic polices of the United States since World War II and in recent years are included in answers to previous questions. As a general comment, the economic policies of the United States must stress growth above everything. Certainly balanced economic growth will not be accomplished unless a solution to the problem of persistent pressures on costs is found. Economic growth with rising costs and rising prices will mean that large numbers of people in our economy will not be able to share in the benefits of such growth. The growth rate itself will be limited by this fact.

There will be little, if any, progress for those who are not in a position to increase their incomes, at least in line with the rising price level.

I do not believe that we must accept a gradual inflationary trend as either desirable or necessary in order to maintain full employment or to insure economic progress. Arguments in favor of creeping inflation are not at all convincing. There is no evidence that a gradual rise in

price level will in itself insure growth. Moreover, a creeping inflation of only say 2 percent a year becomes a serious inflation in a matter of a few years—22 percent in 10 years, and almost 50 percent in 20 years. Those who advocate a gradual inflationary trend as necessary provide us with no criteria as to the extent of the inflation that should be permitted—whether it should be 1 percent, 2 percent, 3 percent a year, etc.

7. Give your opinion of the effect on our economy of current Federal, State, and local government spending.

8. Give your opinion of the effect on our economy of current Federal, State, and local taxation.

Certain comments with respect to the effect on our economy of current governmental spending and taxing programs have been included in the answers to some of the above questions.

The effect on our economy of governmental spending and taxing programs is summed up in the fact that Federal, State, and local government purchases of goods and services account for 20 out of every 100 dollars of our gross national product and that the total of all government spending equals nearly 30 out of every 100 dollars of national income. Federal Government purchases account for 11½ percent of our national output and State and local governments for about 8½ percent. These percentages indicate the extent to which governmental agencies make decisions which affect the allocation of our national production and economic resources.

State and local government expenditures are tied closely to the trend in population and to shifts in population. In the past 10 years these expenditures have shown a steady upward trend. The bulk of outlays for these governmental units are for school and highway purposes which are certainly necessary from the standpoint of promoting long-term economic progress.

Federal Government spending has proved to be far more volatile, mainly because of changes in the level of defense expenditures. The sharp downswing in defense spending in 1953 was undoubtedly a major factor contributing to the business decline at that time. I believe also that the sharp cutback in defense orders in the last half of 1957 has been an important factor in the current economic decline. If it was possible to smooth out the rate of Government order placement, at least during the fiscal year, there would be an important contribution to a more stable economic growth.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes, and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

Fiscal policy deals with the amount, the type, and the timing of governmental spending and taxing programs. Fiscal policy can be and has been an important vehicle for shifting the distribution of income in the United States—for altering the allocation of our Nation's economic resources.

The net effect of fiscal policy, is, of course, reflected in the balance between expenditures and revenues—the deficit or surplus position. A moderate cash surplus exerts a mildly contractive influence and often is helpful in pursuing a policy of price stability. A long-term objective of a balanced budget with a moderate surplus to accomplish

a gradual reduction in the Federal debt would seem to represent a sound policy.

Monetary and credit policies, of course, deal with the supply of money and the amounts and terms of available credit. I have commented earlier as to the effectiveness of monetary policy in controlling inflation or avoiding deflation. It is imperative that we do not overestimate the ability of either fiscal or monetary measures in themselves to expand economic activity. The soundest way to foster economic growth is to adopt those fiscal and monetary policies which are consistent with maximum effort in the private economy.

It is not possible to be categorical about specific monetary or fiscal policies which would apply in all situations. In a sharp business downturn it is possible that certain fiscal measures will have to be adopted on a temporary basis to stimulate a return to reasonable levels of business and employment. These temporary fiscal measures may or may not be consistent with the policy of attempting to solve the long-term inflation problem.

10. (*a*) Comment generally on the adequacy or inadequacy of the United States monetary system. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits.) Also, please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

(*b*) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

I have no additional comment on this question.

11. (*a*) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy?

(*b*) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full employment goals?

I believe that inflation and unemployment can exist side by side in our economy for reasons discussed in the answer to question 1. The answer basically is that not all prices increase or decline at the same time. At any particular time, the price of labor may rise relative to the price of other items. This in turn boosts unit production costs which puts pressure on final prices. The higher price for the product or service may restrict the growth of the market for the product or service with possible result of a decline in production and employment.

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy?

It is my opinion that the growth in the private debt in recent years does not pose a threat to the stability or vitality of the American economy. There has, of course, been much concern expressed over the rise in consumer debt, particularly in 1955, as a result of the sharp increase in automotive sales that year. There is no question that at a particular time a boom in consumer credit and a boom in business borrowing will contribute to inflation and that on the downside, a sharp reduction in borrowing by either business or consumer will aggravate the situation.

As a general rule, the consumer has done an excellent job in handling his accounts, even in a situation of serious business decline. In the two previous postwar recessions, consumer credit actually increased,

providing an important anchor around which the business upturn was eventually achieved. It is possible in the present decline that consumer credit will contract but there are no magic formulas by which the actions of consumers can be predicted or changed. A restrictive monetary policy can be helpful in discouraging speculative excesses in borrowing during boom conditions and an easy money policy may encourage debt creation during a period of business decline.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy?

There are no precise statistical measures which indicate at what point the Federal Government should take action to counteract a downturn in business by reducing taxes or increasing expenditures. To evaluate the trend in general business conditions we find it necessary to examine trends in many statistical series—unemployment, production, consumer income, retail sales, etc. Our viewpoint as to trend of business in the months ahead is really a matter of judgment as to what these individual trends portend. The danger of using a single guide to action, such as 6 percent of the labor force unemployed, is that such a measure does not consider who is unemployed, how long have they been unemployed, is the increase in employment the result of a large influx into the labor force (which for statistical purposes is poorly defined), a decline in employment opportunities, etc.

14. How much of a factor in your opinion has deficit spending by the Federal Government since the end of World War II been in contributing to or producing inflation?

Federal Government deficits have not been a major factor contributing to inflation since World War II. In fact, for the period since World War II, taken as a whole, the Federal Government has run a small cash surplus. This does not mean that governmental spending and taxing programs have not encouraged inflation.

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

The answer to this question depends upon the definition of the term "full employment goals."

In a free economy the allocation of economic resources is largely determined by consumer choice manifested in millions of individual spending decisions. Mobility of labor and capital from company to company in the same industry and from industry to industry is required at all times in order to adjust production higher and lower with changes in consumer demand. Shifts in consumer demand are frequently sudden and the adjustment in production is not immediate, with the result that both labor and capital in a particular situation may be temporarily unemployed. If the consumer is to be allowed free choice in the expenditure of his income, then it is impossible to guarantee him 100 percent employment at all times. Thus, full employment in the sense of a job for everyone can only be attained in a completely state-directed economy. Such a concept is not only incompatible with a free society but it is also incompatible with the maintenance of a stable dollar.

The problem then, is to achieve a balance between the maximum employment of our economic resources on the one side, and the goals of a free society and the maintenance of a stable dollar on the other side. This is the kind of balance, however, that does not lend itself to precise calibration terms of a percentage of the labor force that is unemployed. For example, should Government action be taken to increase employment when unemployment is equivalent to 4 percent, 5 percent, 6 percent, et cetera, of the labor force? There is wide disagreement on this point.

The matter is further complicated in that the interpretation of available statistical information on unemployment is uncertain. The Department of Labor reported that on February 28, there were 5,170,000 unemployed, but this figure included approximately 700,000 persons who had not been working in 1957, in many instances wives and children in families where the major wage earner had been laid off. Also, the unemployment figures include persons who ordinarily work part time, such as wives, but who are not seeking, nor would they accept, fulltime employment.

These are the problems with which Congress wrestled in drafting the Employment Act of 1946. As a result, this legislation was not formulated on the premise of a 100-percent-employment goal, but instead provides that it is the continuing policy of the Federal Government to use all practical means to create and maintain employment opportunities for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power in a manner calculated to foster and promote free competitive enterprise.

It is my firm conviction that economic progress can be achieved without accepting a gradual inflationary trend and that reasonably full employment of our economic resources can be achieved while maintaining a stable dollar, provided we find some solution to the problem of wage-push inflation.

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

By their very nature, escalator provisions in wage contracts insure that those covered by the contracts will receive wages at least in line with the trend in price levels. In inflation situation, those persons whose incomes are relatively fixed will suffer a loss in real purchasing power. In fact, a transfer of purchasing power from persons with relatively fixed incomes to those in a position to obtain cost-of-living adjustments takes place. The long-term labor contract with the annual improvement factor and the escalator provision are relatively new in business experience. The full economic implications of these provisions are by no means clear though they have served to foster wage-push inflation. It does seem likely that in view of the trend of business at present and in view of the limited increase in output per man-hour in recent years, businessmen will carefully evaluate the possible advantages to be gained in granting contracts including these provisions in the future.

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.

Comments as to the major factors in the present business downturn are included in answers to previous questions. With respect to govern-